Supreme Court, U.S.
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No. 03 391

In The
Supreme Court of the United States

MICHAEL GALESI, DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; DELAWARE FLOOD COMPANY 1976 DH; DELAWARE FLOOD COMPANY 1977 EH; DELAWARE FLOOD COMPANY 1978 FH; DELAWARE FLOOD COMPANY 1979 Ltd.,

Petitioners,

v.

BERNARD OLCOTT,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Was the non-collateral sanction of $3.6 million (one of the largest sanctions in the history of the United States) imposed in derogation of Article III of the Constitution when the District Court did not have subject matter jurisdiction?

2. When petitioner has been sanctioned $402,527.98 for failure to provide an accounting, and is ordered to produce the accounting yet again at a subsequent hearing, but prior to that hearing the District Court dismisses all of the causes of action, is the imposition of a non-collateral additional $3.6 million sanction in derogation of this Court's decision in *United States Catholic Conference v. Abortion Rights Mobilization, Inc.*, 108 S.Ct. 2268 (1988)?

3. Does a $3.6 million non-collateral sanction against petitioners for failure to produce an accounting, on top of a previously assessed $402,537.98 sanction for the same conduct, violate the Due Process Clause of the Fifth Amendment (applied through the Fourteenth Amendment) when respondent received the benefit of his bargain plus $800,000 in cash and $700,000 net in income tax deductions?

4. Should this Court resolve the conflict among the circuits presented by, on the one hand, (i) the opinion of the United States Court of Appeals for the Tenth Circuit in this case, (ii) the opinion of the United States Court of Appeals for the Second Circuit in *Hernandez v. Conriv Realty Assoc.*, 116 F.3d 35 (2d Cir. 1997), and (iii) the opinion of the United States Court of Appeals for the Ninth Circuit in *In re Exxon Valdez*, 102 F.3d 429 (9th Cir. 1996), and, on the other hand, the opinion of the United States Court of Appeals for the Third Circuit in *In re Orthopedic "Bone Screw" Products Liability Litigation*, 132 F.3d 152 (3d Cir. 1997)?

QUESTIONS PRESENTED – Continued

5. When the terms of the Pre-Trial Order (prepared and signed by respondent's and petitioners' counsel and signed by the District Court) (i) hold the District Court dismissed all of respondent's causes of action, (ii) no order revoking that holding was entered, and (iii) respondent did not cross-appeal the dismissal, may the United States Court of Appeals for the Tenth Circuit, consistent with the Due Process Clause of the Fifth Amendment (applied through the Fourteenth Amendment) and with Article III of the Constitution and/or the provisions of Rule 16, Fed.R.Civ.P., hold the District Court did not dismiss respondent's causes of action?

6. When the terms of the order pursuant to which the $3.6 million non-collateral sanction was assessed require the District Court to determine how much of respondent's money was utilized in accordance with the terms of the agreements among the parties, may the United States Court of Appeals for the Tenth Circuit, consistent with the Due Process Clause of the Fifth Amendment (applied through the Fourteenth Amendment) refuse to review how much of respondent's money was utilized in accordance with the terms of the agreements on the ground that to do so requires an interpretation of the agreements among the parties, thus depriving petitioners of appellate review of the very basis of the $3.6 million non-collateral sanction?

7. Does the assessment of $2.5 million for 21 years of pre-judgment interest, as part of the $3.6 million non-collateral sanction, violate the Due Process Clause of the Fifth Amendment (applied through the Fourteenth Amendment) when Respondent received the benefit of his bargain plus $800,000 in cash and $700,000 net in income tax deductions?

QUESTIONS PRESENTED – Continued

8. When the uncontradicted evidence shows Petitioners had no loss, and there was no determination of the outcome of the controversy among the parties, may the District Court assess a $3.6 million civil contempt sanction in derogation of the Due Process Clause of the Fifth Amendment (applied through the Fourteenth Amendment) and of this Court's decision in *United States v. United Mine Workers*, 330 U.S. 258 (1947)?

CORPORATE DISCLOSURE

Pursuant to Supreme Court Rule 29.6, Michael Galesi and the Delaware Flood Companies, state that Delaware Flood Company, Delaware Flood Company 1976 DH, Delaware Flood Company 1977 EH, Delaware Flood Company 1978 FH, and Delaware Flood Company 1979 EH were privately held limited partnerships. None of the limited partnership shares were held by any publicly traded company.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit ("Tenth Circuit") is reported at 327 F.3d 1115 (10th Cir. 2003), and is reproduced as Appendix 1-21, (this opinion marked the third time this case (which began in 1982) was before the Tenth Circuit, and is referred to herein as "*Olcott III*"). The opinion of the Tenth Circuit rendered in 1996 is reported at 76 F.3d 1538 (10th Cir. 1996), and is reproduced as Appendix 69-117, (this opinion is referred to herein as "*Olcott II*"[1]).

The Findings of Fact and Conclusions of Law of the District Court, awarding $1,077,014.70 as sanctions, is not officially reported and is reproduced as Appendix 24-50. The judgment of the District Court is not officially reported, and is reproduced as Appendix 22-23. The August 27, 2003, Order of the District Court awarding yet another $2.5 million in "pre-judgment interest" sanctions, is not officially reported and is reproduced as Appendix 56-57. Other orders of the District Court are directly relevant: (i) the "2-8-90 Order", reproduced as Appendix 31-50; (ii) the "4-30-93 Order", reproduced as Appendix 58-68; (iii) the "2-5-98 Order", reproduced as Appendix 118-21; (iv) the "Pre-Trial Order" of 8-9-00, reproduced as Appendix 122-49; and (v) the "1-29-02 Order" awarding respondent $1,077,014.70 pre-judgment interest on the sanctions, Appendix 51-55.

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[1] The first appeal to the Tenth Circuit resulted in an order which is of no moment to this Petition for Writ of Certiorari.

JURISDICTION

The judgment of the Tenth Circuit was entered on April 24, 2003. Petitioners filed a petition for rehearing, which was denied on June 9, 2003. (App. 128). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1) to review the Tenth Circuit's decision on a writ of certiorari.

CONSTITUTIONAL PROVISIONS

Article III of the United States Constitution

Section. 1. The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.

Section. 2. The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority; – to all Cases affecting Ambassadors, other public Ministers and Consuls; – toto all Cases of admiralty and maritime Jurisdiction; – to Controversies to which the United States shall be a Party; – to Controversies between two or more States; – between a State and Citizens of another State; – between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the citizens thereof, and foreign States, Citizens or Subjects.

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the congress shall make.

The Trial of all Crimes, except in Cases of Impeachment, shall be by Jury; and such Trial shall be held in the State where the said Crimes shall have been committed; but when not committed within any State, the Trial shall be at such Place or Places as the Congress may by Law have directed.

Section. 3. Treason against the United States, shall consist only in levying War against them, or in adhering to their Enemies, giving them Aid and Comfort. No Person shall be convicted of Treason unless on the Testimony of two Witnesses to the same overt Act, or on Confession in open Court.

The Congress shall have Power to declare the Punishment of Treason, but no Attainder of Treason shall work Corruption of Blood, or Forfeiture except during the Life of the Person attained.

Fifth Amendment of the United States Constitution

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any

criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Fourteenth Amendment of the United States Constitution, Section 1

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

STATEMENT OF THE CASE

A. Procedural History

This case, pending since 1982, involves one of the largest sanctions in the history of the United States. That sanction [$1,077,014 (App. 22-30) plus twenty-one (21) years of pre-judgment interest (App. 56-57) (another $2.574 million)[2]] was imposed in the absence of jurisdiction, and is in addition to the $402,527 sanction previously imposed against petitioners for the same conduct. *Olcott II*, 76 F.3d 1538 (10th Cir. 1996), (App. 69-117). In addition,

[2] See Appendix 56-57 for the August 27, 2003 order of the District Court assessing pre-judgment interest.

the decision of the United States Court of Appeals for the Tenth Circuit is in direct conflict with relevant decisions of this Court and with a decision of the United States Court of Appeals for the Third Circuit.

In 1982, respondent filed this action in the District of New Jersey. (App. 73). The District of New Jersey granted petitioners' motion for a change of venue, and the case was transferred to the Northern District of Oklahoma in 1983. (*Id.*) Respondent alleged four federal securities claims (one for each of 1976-1979), three state law tort claims and three state law contract claims. (App. 24). During discovery, the District Court entered a sanctions order, the 2-8-90 Order, for petitioners' failure to comply with the District Court's orders to produce an accounting. (App. 31-50). That 2-8-90 Order said respondent was "entitled" to a default judgment of $1.9 million "less any portion of those funds which Defendants can establish were utilized for legitimate purposes under the terms and provisions of the Limited Partnership Agreements. There will be a trial at which the burden will be upon the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties . . . Defendants still must comply with the accounting Orders of this Court and correct the deficiencies as found by the Court's expert." (App. 49-50).

After entry of the 2-8-90 Order, the District Court ignored it. Instead, the District Court (i) dismissed all of the federal securities claims; (ii) summarily dismissed the state law claims because of dismissal of the federal claims; and (iii) entered the 4-30-93 Order (App. 58-68) awarding sanctions to respondent for petitioners' failure to comply with the District Court's orders to produce an accounting,

in the amount of $402,527.98.[3] *Olcott II*, 76 F.3d 1538, (App. 69-117). The 4-30-93 Order imposing the $402,527.98 in sanctions compensated respondent in full for the failure to produce the accounting. The 2-8-90 Order, which the District Court ignored in the 4-30-93 Order, said respondent was entitled to a default judgment for failure to produce the accounting. Petitioners and respondents appealed the 4-30-93 Order to the Tenth Circuit. *Olcott II*, 76 F.3d 1538, (App. 69-117).

The Tenth Circuit opinion on the appeal of the 4-30-93 Order, 76 F.3d 1538 (10th Cir. 1996), *Olcott II*: (i) affirmed the dismissal of the 1976-1978 federal securities claims and remanding for a statute of limitations determination on the 1979 claim; (ii) ordered the District Court on remand to make an appropriate supplemental jurisdiction analysis of the state law claims; (iii) affirmed the sanctions award of $402,527.98; and (iv) denied respondent's request to enter a final judgment in favor of respondent on the $1.9 million order (the 2-8-90 Order). (App. 69-117). In denying respondent's request to enter a judgment for the $1.9 million, the Tenth Circuit said:

> *The purpose of the default judgment was to coerce the defendants into completing the accounting for trial. . . .* ***After the court dismissed Mr. Olcott's cause of action, the default judgment became moot because the court's decision abrogated the possibility of a trial.*** (emphasis added).

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[3] This sum constituted all of respondent's attorney fees and accounting fees in connection with the failure to produce the accounting, as well as the fees of the Court's own expert.

Olcott II, 73 F.3d. at 1558, (App. 114). Upon remand of the case, the District Court again dismissed the 1979 federal securities claim, but retained supplemental jurisdiction of the state law claims. However, in its 2-5-98 Order, the District Court dismissed all of the state law claims, saying the "trial of this matter is limited to the issues encompassed by the default judgment previously awarded" by the 2-8-90 Order. (App. 121). The 2-5-98 Order noted respondent's expression of concern that if the trial were held on the default judgment, and not on one or more of respondent's state law claims, "he may incur problems proving his case if the default judgment is ultimately reversed." (App. 121).

The Pre-Trial Order of 8-9-00 discussed the action taken by the District Court in the 2-5-98 Order, saying clearly and unequivocally that the 2-5-98 Order dismissed all respondent's state law causes of action.[4] (App. 125-26). The Pre-Trial Order was prepared and signed by respondent's and petitioners' counsel and signed by the District Court. Respondent, in the appeal taken by petitioners which resulted in *Olcott III*, 327 F.3d 1115, Appendix 1-21, did not cross-appeal the dismissal of all of his causes of action, despite his counsel's having prepared and signed the Pre-Trial Order stating the causes of action were

[4] In discussing the 2-5-98 Order, the 8-9-00 Pre-Trial Order says: "Hence, ***Plaintiff's claims*** for common law fraud, breach of contract, rescission, restitution, negligence, mismanagement, misfeasance, partnership waste, breach of fiduciary duties and interference with business and investment objectives, ***were dismissed.***" (emphasis added) (App. 125-26). In addition, the 8-9-00 Pre-Trial Order noted under respondent's "contentions", Appendix 140, ¶12, that the 2-8-90 conditional judgment may not be sustainable on appeal.

dismissed, and despite his counsel's having twice told the District Court the conditional order might not be sustainable on appeal.

Without any discussion of Rule 16, Fed.R.Civ.P., the Due Process Clause, or respondent's failure to cross-appeal the dismissal of all of his causes of action, the Tenth Circuit, in *Olcott III*, held there was no dismissal of respondent's claims, and the District Court made an "unfortunate misstatement" in saying dismissal had occurred.[5] In so holding, the Tenth Circuit said, n.7, (App. 10), the District Court "presumably" intended to lift the default sanction and proceed to trial on the merits if the accounting was supplied. The record flatly contradicts the Tenth Circuit's "presumption". As noted on p. 41 of petitioners' opening brief in the Tenth Circuit in *Olcott III*, the District Court said at trial:

> I'm saying a perfect accounting does not remove any of the obligations of the sanction previously imposed. Doesn't change that except it meets the requirement to account. . . . The judgment would still stand . . . [i]f you couldn't show credits. (App. 208).

In *Olcott II*, the Tenth Circuit said:

> The purpose of the default judgment was to coerce the defendants into completing the accounting for trial. . . . After the court dismissed Mr. Olcott's cause of action, the default judgment became moot because the court's decision abrogated

[5] *Olcott III* offers no authority for its transmogrification of jurisdictional pig-iron into jurisdictional "gold."

> the possibility of a trial. 76 F.3d at 1558, (App. 114).

In *Olcott III*, the Tenth Circuit said:

> The set-off hearing was Defendants' final opportunity to comply with the court's accounting orders. 327 F.3d 1115 at 1121, n.7, (App. 10).

The District Court, at the outset of the trial that commenced August 29, 2000, said: "This trial is set for the purpose of completing that accounting." (App. 152). The 2-8-90 Order itself says: "Defendants still must comply with the accounting Orders of this Court and correct the deficiencies as found by the Court's expert." (App. 50).

A non-jury trial was held August 29 through September 1, 2000. On June 6, 2001, the District Court entered Findings of Fact and Conclusions of Law, Appendix 4-50, giving "credits" to petitioners of $623,161.00 and $191,824.30, and awarding respondent a "default judgment" of $1,077,014.70. The judgment of the District Court, June 6, 2001, Appendix 22-23, entered judgment for $1,077,014.70, "plus interest". On 1-29-02, the District Court entered judgment for $1,679,144.55 of pre-judgment interest on the sanctions. (App. 51-55).

Petitioners appealed to the Tenth Circuit. Respondent did not cross-appeal the dismissal of his causes of action. In *Olcott III*, the Tenth Circuit affirmed the decision of the District Court, except for the calculation of pre-judgment interest which had been made under Oklahoma law, ordering the calculation to be made under New Jersey law.

Petitioners filed a petition for rehearing en banc, which was denied. (App. 150). In an 8-27-03 Order, the

District court awarded $2.573 million in pre-judgment interest, Appendix 56-57.

B. Statement of the Facts

In 1976-1979 respondent invested $1.9 million in year-end oil and gas limited partnerships. One of respondent's primary purposes in making the investment was income tax deduction of 100% of the investment in the year of investment. (App. 206). Under Internal Revenue Service regulations, such same-year income tax deduction was permitted only if the oil and gas limited partnership entered into a "turnkey" drilling contract, wherein the drilling contractor was paid all the money up front, in the year of the investment, and in return undertook the obligation to drill a specified number of wells, regardless of the ultimate cost to the drilling contractor. (App. 201). The oil and gas limited partnerships in which respondent invested were affiliates of the drilling contractor, of which respondent was aware. The price to be paid to the drilling contractor was negotiated with the limited partnership investors, including respondent. Respondent testified he not only had the drilling contracts in his possession at the time he signed the limited partnership agreements, but also engaged in "simultaneous acceptance" of the drilling contracts by signing the limited partnership agreements. (App. 203-04).

Uncontroverted evidence at the 2000 trial, from independent petroleum engineers, showed the $1.9 million paid to the drilling contractor was the market price for the services rendered, (App. 216-19), and that the drilling contractor completed more well work in each of the limited partnerships than was required in the contracts. (App.

215-16). Further uncontroverted evidence at the 2000 trial showed all of the wells were drilled. (App. 153-96). ***Respondent's own expert witness (who, for years, had been the District Court's own accounting expert in this case) testified if all of the wells were drilled, and the appropriate price was $1.9 million, then $1.9 million should have been credited against the $1.9 million conditional default judgment under the terms of the agreement among the parties.*** (App. 209-10).

Uncontroverted evidence at trial showed respondent received, in addition to all of the wells being drilled at market prices for the $1.9 million amount of his investment: (i) $623,161 from oil and gas sales, (App. 210-11); (ii) a net $199,824.30 from the exercise of a "put" on the 1977 limited partnership investment, (App. 197); and (iii) $700,000 in net tax benefits, (App. 198-99).

During the discovery process, petitioners and respondent agreed to an accounting order, wherein petitioners were required to account for where respondent's money went. Because the drilling contractor commingled the funds received from the limited partnerships with its operating funds, (as it had to do in order for the investors to take an income tax deduction in the same year they paid their money) this was not an easy task. Petitioners engaged the services of KPMG Peat Marwick to perform the accounting, and that firm expended over 1600 hours in just over three months in 1988 on the project. (App. 220-21). The District Court found the accounting insufficient. (App. 31-50). The District Court heard evidence from counsel for petitioners that their client, petitioner Galesi,

was not going to produce an accounting. (App. 49, ¶46). The District Court found, as a result, that petitioners willfully failed to produce the agreed accounting. (App. 49, ¶48).

During the process of the District Court holding several hearings on the failure to produce the agreed accounting, the District Court entered the 2-8-90 Order, Appendix 31-50, saying respondent was "entitled" to a $1.9 million judgment, subject to: (i) petitioners being given credit at a trial with a reversed burden of proof, for all funds "legitimately" spent under the terms of the agreements among the parties; and (ii) petitioners producing the required accounting. (App. 49-50, ¶¶4 & 5). However, when the District Court entered its final sanction order on 4-30-93, there was no mention of the 2-8-90 Order. (App. 58-68). Instead, the District Court sanctioned petitioners $402,527.98 (this fully compensatory amount being all of respondent's attorney fees and accountants' fees, as well as the fees of the court-appointed accounting expert, dealing with the failure to produce the agreed accounting). (App. 64 and 76).

On the merits, the District Court dismissed all of respondent's federal and state claims. (App. 71). On appeal, respondent cross-appealed, asking for entry of judgment on the 2-8-90 Order saying he was "entitled" to a $1.9 million judgment. (App. 113). The Tenth Circuit, in *Olcott II*, 76 F.3d 1558, denied respondent's request for a $1.9 million judgment, noting the District Court's dismissal of all of the causes of action made the default judgment "moot[,] because the court's decision abrogated the possibility of a trial." (App. 114).

On remand, the District Court dismissed the remanded federal claim, but exercised supplemental jurisdiction over the state law claims. (App. 7). The District Court also reinstated the 2-8-90 Order. Subsequently, in the 2-5-98 Order, the District Court again dismissed all of the state causes of action, over the objection of respondent, which objection was duly noted in the 2-5-98 Order (respondent objecting that he would have problems proving his case if the default judgment were ultimately reversed). (App. 118-121). The Pre-Trial Order of 8-9-00 specifically states that the 2-5-98 Order dismissed all of respondents' claims.[6] (App. 125-26).

The District Court conducted a non-jury trial, despite the dictates of the Pre-Trial Order, that the trial would be a jury trial. (App. 126). Under *Olcott II*, 76 F.3d at 1558, the possibility of this trial was "moot", because the dismissal of all of the claims abrogated the possibility of a trial on the 2-8-90 Order. (App. 114).

On appeal from the 2000 trial (such appeal being the case before this Court), respondent did not cross-appeal the District Court's dismissal of all of his causes of action.

On appeal from the 2000 trial, the Tenth Circuit held, quite remarkably, that despite the clear and unequivocal "approved as to form and substance" statement in the Pre-Trial Order (prepared and signed by counsel for respondent and petitioner, and signed by the District Court), and despite the requirements of Rule 16, Fed.R.Civ.P., that the Pre-Trial Order controls all subsequent proceedings, the

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[6] *See* n.4, *supra*.

District Court did not dismiss respondent's causes of action, and the terms of the Pre-Trial Order were "an unfortunate misstatement." *Olcott III*, 327 F.3d at 1121, (App. 10). In addition, the Tenth Circuit rejected all of petitioners' other claims on appeal, remanding solely for a recalculation of pre-judgment interest under New Jersey law instead of Oklahoma law. (App. 21). On 8-27-03 the District Court entered an Order awarding Plaintiff $2,573,974.77 in pre-judgment interest. (App. 56-57).

REASONS FOR GRANTING THE WRIT

A. The Tenth Circuit's decision so far departs from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's supervisory power

1. The Tenth Circuit Opinion creates an appeal respondent did not make.

In *Olcott II*, 76 F.3d 1538, the District Court dismissed all of respondent's causes of action. Respondent appealed the dismissal. The Tenth Circuit remanded, ordering reconsideration of one federal claim and ordering the District Court to apply principles of supplemental jurisdiction on the state law claims.

In *Olcott III*, 327 F.3d 1115, respondent prepared and signed the 8-9-00 Pre-Trial Order which said the 2-5-98 Order dismissed all of respondent's causes of action. Counsel for petitioners and the District Court signed the 8-9-00 Pre-Trial Order. Respondent complained to the District Court that the 2-5-98 Order of dismissal would spell trouble for him if the default judgment were not upheld on appeal, and the District Court so noted in its 2-5-98 Order. (App. 121).

Respondent reiterated this same concern in his "contentions" in the 8-9-00 Pre-Trial Order. (App. 140, ¶12). Respondent did not appeal the dismissal of all of his state law causes of action.[7]

As a result of the foregoing, *Olcott III* presents an important Due Process and Article III issue. *A fortiori* no circuit court may create an appeal on an issue a party has failed to appeal. When respondent failed to cross-appeal the dismissal set forth in the document which controlled[8] the trial (the 8-9-00 Pre-Trial Order), the issue was not reviewable upon appeal.

The Tenth Circuit opinion in *Olcott III* completely fails to address these important issues concerning the District court's dismissal of all of respondent's causes of action in the 2-5-98 Order and in the 8-9-00 Pre-Trial Order:

1. Respondent prepared and signed the Pre-Trial Order saying all of respondent's causes of action were dismissed by the District Court.

2. Respondent complained both in the 2-5-98 Order and in the Pre-Trial Order that he would be in trouble if default judgment were stricken, since his causes of action were dismissed.

3. Respondent wholly failed to cross-appeal the dismissal of all of his causes of action.

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[7] In *Olcott III*, respondent bizarrely suggested in his answer brief there would have been no "pragmatic benefit" for him to cross-appeal the dismissal.

[8] The Pre-Trial Order itself provides it controls the trial and supersedes the pleadings. (App. 148). Rule 16, Fed.R.Civ.P., is to the exact effect.

4. A circuit court is without power to create an appeal where the party fails to appeal.

5. The Pre-Trial Order provides that it controls the trial and supersedes the pleadings. No order was ever entered revoking the dismissal.

6. Rule 16, Fed.R.Civ.P., provides that the Pre-Trial Order controls the trial and supersedes the pleadings.

In addition to ignoring the foregoing matters in *Olcott III*, the Tenth Circuit blatantly misstated the terms of the 2-5-98 Order, by asserting that Order noted the state law claims "were still viable." 327 F.3d 1115, 1121, (App. 10). This statement is egregiously false, as illustrated in two ways. First, the Pre-Trial Order, prepared and signed by respondent and petitioners and signed by the Court, reflects the clear and unequivocal understanding and agreement of the parties and the Court that the 2-5-98 Order *dismissed* all of respondent's causes of action. Second, the language of the 2-5-98 Order does not speak of "viability" of any of respondent's claims. Instead, under the 2-5-98 Order the only thing that remains to be done in the entire case is to try the issues encompassed by the default judgment previously awarded:

> The primary issue raised by the motions for summary judgment is whether Plaintiff is entitled to pursue his state law claims and receive the benefit of the $1.9 million dollar [sic] default judgment he has previously been awarded. Plaintiff has stated both at the preliminary pretrial conference and at previous status conferences, that he wishes to accept the $1.9 million dollar [sic] default judgment, but that he wishes also to be able to put on the evidence for his fraud case as well. Plaintiff concedes that the damages are the same, but argues that proving the fraud

> cased [sic] is necessary because he may incur problems proving his case if the default judgment is ultimately reversed. This is not sufficient reason to allow Plaintiff to put on evidence to prove a fraud claim, when [P]laintiff [sic] already has received a judgment in his favor entitling him to the same damages. In the interest of efficiency and judicial economy, the trial of this matter is limited to the issues encompassed by the default judgment previously awarded.

(App. 120-21). In addition, *Olcott III* also blatantly misstates the District Court's intention at the trial. In n. 7, 327 F.3d 1115 at 1121, (App. 10), *Olcott III* says: "The set-off hearing was Defendants' final opportunity to comply with the court's accounting orders. In the event Defendants complied, the court presumably intended to lift the default sanction and proceed to trial on the merits." The District Court intended no such thing, as shown in Petitioners' opening brief on appeal, p. 41, where the District Court's statement at trial was quoted: "I'm saying a perfect accounting does not remove any of the obligations of the sanction previously imposed. Doesn't change that except it meets the requirement to account.... The judgment would still stand ... [i]f you couldn't show credits." (App. 208). Thus, the District Court flatly stated the default judgment stood even if a perfect accounting were supplied unless credits were shown. Petitioner's right to a trial on the merits, consequently, was completely precluded.

Olcott III endeavors to bolster its flatly wrong misstatement of what the District Court intended to do if the accounting were supplied, by asserting the District Court "merged" respondent's claims into the default order. 327 F.3d at 1122, (App. 10-11). Neither the 2-5-98 Order (App.

118-121) nor the Pre-Trial Order (App. 122-49) speaks of "merger". Nor, indeed, could they. As a matter of elemental common law, "merger" of causes of action occurs only after a *judgment*. The 2-8-90 Order is not a judgment,[9] nor was it ever intended as such, because the very terms of the 2-8-90 Order require a trial at which petitioners are entitled to credit for monies "utilized for legitimate purposes under the terms and provisions of the Limited Partnership Agreements." (App. 50, ¶4). The District Court did not enter, nor did he intend to enter, any judgment before the trial was over. Indeed, before *Olcott II* the District Court conducted proceedings for three years between the 2-8-90 Order and the 4-30-93 Order (in which the District Court gave no effect whatever to the 2-8-90 Order). The District Court, before *Olcott II*, dismissed all of the causes of action, which *Olcott II* said abrogated the possibility of a trial, i.e., because there was no jurisdiction. Then, after *Olcott II* was handed down, the District Court engaged in "deja vu all over again," by again dismissing all of the causes of action.

It was not until 6-6-01 that the District Court entered *judgment* on the 2-8-90 Order. (App. 22-23). At that point, had causes of action been extant, they would have merged into that judgment. But because the causes of action were dismissed, there was nothing to merge.

Olcott III cites no authority whatsoever to support a pre-judgment "merger" of causes of action. Counsel knows

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[9] Respondent has long since conceded the 2-8-90 Order is not a judgment. *Olcott II*, 76 F.3d at 1558, notes respondent asked the Tenth Circuit to reduce the 2-8-90 $1.9 million order to a judgment.

of no such authority. Moreover, the very concept of pre-judgment "merger" of causes of action is antithetical to the very basis of our common law.

The dismissal of all of respondent's causes of action abrogated the possibility of a trial just as the Tenth Circuit stated in *Olcott II*: "After the court dismissed Mr. Olcott's cause of action, the default judgment became moot because the court's decision abrogated the possibility of a trial", *Olcott II*, 76 F.3d. at 1558, (App. 114).

The decision of the Tenth Circuit in this case should be summarily reversed. Alternatively, the Court should grant the Writ of Certiorari to review the action of the Tenth Circuit. In addition, as noted below, the decision of the Tenth Circuit is directly contrary to a Third Circuit case, and to this Court's precedents.

2. The action of the circuit court in affirming the sanction is a troubling Due Process violation.

The 2-8-90 Order, Appendix 31-50, provided the $1.9 million would be reduced to the extent Defendants could establish "to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties." (App. 50, ¶4). At trial, petitioners presented uncontradicted evidence that: (i) the entire $1.9 million paid by respondent was the market price for drilling the wells respondent contracted for; (App. 216-19) (ii) more than the wells required to be drilled were drilled; (App. 215-16 and App. 153-96) (iii) respondent got $700,000 in tax benefits; (App. 198-99) and (iv) respondent got $623,161 in oil and gas runs (App. 210-11) and $199,824.30 from a

"put" (App. 197) all of which showed respondent got everything he was entitled to receive under the agreements of the parties. The District Court rejected all of petitioners' evidence, saying there was a "direct proof" requirement (through unspecified accounting evidence) that was not met. There is no "direct proof" requirement in the 2-8-90 Order (App. 50) or in the terms of the agreements of the parties.[10]

Bizarrely, the Tenth Circuit in *Olcott III*, 327 F.3d at 1125 (App. 17), refused to review the District Court's failure to give credit for expenditures "for legitimate business purposes under the terms of the [agreements of the parties]", holding that such a review "requires this Court to interpret the terms of the underlying investment contract," 327 F.3d at 1125 (App. 17), and "[a]s such, it is a merits argument foreclosed by the district court's default judgment." *Id.* Of course, ***the very terms of the sanction order require an interpretation of the agreements of the parties, since petitioners are to get credit for "any portion of Plaintiff's contribution . . . utilized for legitimate [business] purposes under the terms of the agreements among the parties.***" (App. 50, ¶4). Thus, the Tenth Circuit's refusal to review the District Court's interpretation of the agreements among the parties, as required by the very sanction order itself, is an

[10] Indeed, respondent's own expert conceded if the wells were drilled and the cost attributable to respondent's interest was $1.9 million (as an independent petroleum geologist testified in uncontradicted documents), petitioners should get $1.9 million in "credits." (App. 209-10) [A769]

egregious Due Process violation, warranting summary reversal on this point alone. Petitioners have been denied appellate review of the very basis of the District Court's decision.

In addition, the award of a sanction of $1 million plus pre-judgment interest of $2.5 million is a shocking Due Process violation, where the facts show (i) petitioners already have been sanctioned $402,527 for the same conduct and (ii) respondent received $1.9 million worth of wells drilled, $700,000 in tax benefits, and more than $800,000 in cash (more than he bargained for under the terms of the agreements of the parties). This Court, in *United States v. United Mine Workers*, 330 U.S. 258, 304, 67 S.Ct. 677, 701 (1947), held that if a civil contempt award is intended as a fine it "must of course be based upon evidence of complainant's actual loss." In addition, this Court said the right to receive the "compensatory fine" is dependent on the outcome of the basic controversy. Since respondent had no actual loss, there is nothing to compensate him for. *Olcott III* is silent as to the Due Process implications of a $3.5 million sanction on top of a fully expensed compensatory award of $402,000, (a) for the same conduct, and (b) where respondent had no loss.

B. The decision of the Tenth Circuit decides an important federal question in a way that conflicts with relevant decisions of this Court

The power of a federal court to impose non-collateral sanctions when there is no subject matter jurisdiction lies at the very heart of Article III of the United States Constitution. When a district court or a circuit court goes over the line in imposing such sanctions, particularly where, as here, a sanction in excess of $400,000 has already been

imposed for the same conduct, and now an additional sanction of $3.547 million for the same conduct has been imposed, it is imperative that this Court give careful scrutiny to the exercise of power and to the limits of Article III.

In *Olcott II*, both the District Court and the Tenth Circuit discussed the nature of the $402,000 sanction, in determining its propriety in the absence of jurisdiction. Both courts held the sanction to be sufficiently analogous to a Rule 11 sanction as to come within this Court's decision in *Willy v. Coastal Corp.*, 503 U.S. 131, 112 S.Ct. 1076 (1992). That $402,000 sanction compensated respondent for all of his expenditures in dealing with the lack of the required accounting (and paid the District court's own expert).

Neither the District Court nor *Olcott III*, makes any effort to justify the imposition of the $3.5 million additional sanction for failure to produce the accounting. There is, of course, no such justification, because the sanction was a civil contempt proceeding in the absence of subject matter jurisdiction. The civil contempt nature of the 2-8-90 Order is patent:

1. *Olcott II* says: "The purpose of the default judgment was to coerce the defendants into completing the accounting for trial." 73 F.3d at 1558, (App. 114);

2. *Olcott III* says: "The set-off hearing was Defendants' final opportunity to comply with the court's accounting orders." 327 F.3d at 1121, n.7, (App.10);

3. The District Court said at trial: "This trial is set for the purpose of completing that accounting." (App. 152);

> 4. The 2-8-90 Order itself says: "Defendants still must comply with the accounting Orders of this Court and correct the deficiencies as found by the Court's expert." (App. 50, ¶5).

In *United States Catholic Conference v. Abortion Rights Mobilization, Inc.*, 108 S.Ct. 2268 (1988), two witnesses failed to comply with a district court document subpoena, were held in civil contempt, and ordered to pay a fine of $59,000 per day until the documents were produced. The witnesses challenged subject matter jurisdiction. This Court "concluded that if the District Court was found to be lacking subject matter jurisdiction, . . . the contempt order would also fall." *Willy citing Catholic Conference*, 503 U.S. 131, 138, 112 S.Ct. 1076, 1081 (1992).

This Court further characterized *Catholic Conference* in *Willy v. Coastal Corporation*, 503 U.S. 131, 138, 112 S.Ct. 1076, 1081 (1992), by holding that the civil contempt proceeding must be reversed and the unobeyed order held void when the contempt proceeding is held in the absence of jurisdiction:

> Civil contempt is designed to force the contemnor to comply with an order of the court . . . Rule 11 is designed to punish a party who has already violated the court's rules. *Cooter & Gell*, *supra*, 496 U.S. at 396, 110 S.Ct. at 2456. Given that civil contempt is designed to coerce compliance with the court's decree, it is logical that the order itself should fall with a showing that the court was without authority to enter the decree.

Willy, 503 U.S. at 139, 112 S.Ct. at 1081.

In this case, the District Court ordered a fixed sum to be paid unless the accounting were forthcoming-$1.9

million. This sanction, moreover, was cumulative to the $402,000 sanction previously awarded for failure to produce the accounting. As such, the trial to determine the precise amount of the sanction was no different from the enforcement proceeding in *Catholic Conference* – it was, to borrow *Willy*'s reading of *Catholic Conference*, "designed to force the contemnor to comply with an order of the court. . . . " *Willy*, 503 U.S. at 138, 112 S.Ct. at 1081. As in *Catholic Conference*, then, the 2-8-90 Order cannot be enforced in the absence of subject matter jurisdiction. Because all of the causes of action were dismissed, jurisdiction ceased. The dismissal order, as the Tenth Circuit held in *Olcott II*, "abrogated the possibility of a trial" and "mooted" the 2-8-90 Order.

C. Conflict with decisions of other Courts of Appeal

This Court should grant certiorari because the Tenth Circuit decision finding there is subject matter jurisdiction is in conflict with the decision of the Third Circuit in *In re Orthopedic "Bone Screw" Products Liability Litigation*, 132 F.3d 152 (3d Cir. 1997).

In *Bone Screw*, the Third Circuit cogently set forth the principles determining whether Article III permits a federal court to impose non-collateral sanctions in the absence of subject matter jurisdiction:

> A federal court can only exercise that power granted to it by Article III of the Constitution and by the statutes enacted pursuant to Article III . . . However, despite this inability of a court to decide the merits of a case over which it lacks jurisdiction, a court does have inherent authority both over its docket and over the persons appearing before it. It

has long been recognized that courts are vested with certain inherent powers that are not conferred either by Article III or by statute, but rather are necessary to all other functions of courts . . . The question we face here is whether the inherent power to sanction extends in a case, over which the court lacks subject matter jurisdiction, to permit the court to impose a sanction which will be dispositive of the merits of the case. We think not. We come to this conclusion despite the fact that we recognize that there is abundant authority permitting the imposition of sanctions in the absence of jurisdiction over a case. The Supreme Court held unanimously in *Willy v. Coastal Corp.* that the absence of jurisdiction will not operate automatically to invalidate all proceedings below. The *Willy* Court, however, addressed the imposition of Rule 11 sanctions, awarding attorneys' fees incurred in responding to sanctionable conduct. *Willy* did not involve a dismissal with prejudice. In approving the sanction in *Willy*, the Court relied in large measure on the principle that Article III concerns are not implicated by Rule 11 sanctions since they are collateral to the merits and do not result in the Court assessing the legal merits of a complaint over which it lacks jurisdiction. Courts have an interest in maintaining order. For this reason, Rule 11 sanctions, which are imposed on persons appearing before the court, may be upheld in the absence of jurisdiction where they are consistent with a court's inherent power to manage its docket and maintain order. Permitting the imposition of Rule 11 sanctions by a court, later found to lack jurisdiction over the case, does not affect the appropriateness of such sanctions. *Willy*, 503 U.S. at 138, 112 S.Ct. at 1081.

> Defendants contend that the Supreme Court's ruling in *Willy* is applicable to this case. We conclude, however, that *Willy* is not controlling here because *Willy* involved a sanction collateral to the merits of the case. The sanction of dismissal with prejudice, imposed on Ray, is not collateral to the merits. It acts to terminate the cause of action. A court's power to determine the merits of a case is distinct from its power to exercise authority over a person appearing before the court. This distinction is inherent in the reliance by the Court in *Willy* on the notion that Rule 11 sanctions could stand in the absence of jurisdiction because they were collateral to the merits of the action and did not signal a legal conclusion by the sanctioning court. The defendants seek to obscure this difference. We conclude, however, that where, as here, the court lacks subject matter jurisdiction, it may not act in a way that determines the cause of action even though it may still – as in *Willy* – exercise its authority over the person before the court in the interest of enforcing compliance with the court's procedures . . . where jurisdiction is found to be lacking, there can be no adjudication of the merits of the case. This prohibition must bar the imposition of a sanction which will terminate the case on the merits.
>
> *Bone Screw*, 132 F.3d at 155-57.

The District Court's proceeding with a trial on the 2-8-90 Order imposed a sanction **not collateral to the merits**. A default judgment of necessity goes directly to the merits, because the default is predicated on a cause of action.

The facts presented in this case are the obverse of those in *Bone Screw*, where a dismissal of the case was at issue. The principles are the same. Ironically, *Olcott II* and

Bone Screw are congruent. In *Olcott II*, the Tenth Circuit held the court was without power to conduct a trial on the conditional default judgment, because the dismissal of all of the causes of action abrogated the possibility of a trial – i.e., where there is no jurisdiction, there can be no sanction which deals with the merits of the case.

It must be noted there are two circuit cases which disagree with *Bone Screw*. With the Tenth Circuit now the fourth circuit to speak on this important Article III issue, it is respectfully submitted the time has arrived for this Court to clear up the confusion in the circuit courts. The confusion is particularly well illustrated in the case of *Hernandez v. Conriv Realty Assoc.*, 116 F.3d 35 (2d Cir. 1997). In *Hernandez* the Second Circuit affirmed dismissal of a case with prejudice as a sanction, despite a lack of subject matter jurisdiction. However, some twenty-two (22) days earlier, the Second Circuit had reversed the dismissal of the case because of the absence of subject matter jurisdiction. *Hernandez v. Conriv Realty Assoc.*, (2d Cir. May 1, 1997), http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=2nd&navby=case&no=967561.

In *In re Exxon Valdez*, 102 F.3d 429 (9th Cir. 1996), the Ninth Circuit upheld dismissal of plaintiff's cause of action despite the lack of subject matter jurisdiction, with emphasis placed on "the need to deter others" of the 4000 plaintiffs in the litigation. 102 F.3d at 433.

CONCLUSION

This case strongly suggests granting the writ. Substantial Article III and Due Process issues are presented. In addition, the Tenth Circuit Opinion in this case is in

derogation of this Court's cases of *United States Catholic Conference*, 487 U.S. 72 (1988), and *United States v. United Mine Workers*, 67 S.Ct. 677 (1947). Finally, this case calls for resolution of a split among the circuits on the important issue of the limits of Article III on federal court imposition of non-collateral/civil contempt sanctions in the absence of subject matter jurisdiction.

Respectfully submitted,

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PUBLISH

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

BERNARD OLCOTT,

Plaintiff-Appellee,

v.

DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; LAYTON OIL COMPANY, a Kansas corporation; WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH; DELAWARE FLOOD COMPANY 1977 EH; DELAWARE FLOOD COMPANY 1978 FH; DELAWARE FLOOD COMPANY 1979 Ltd; MICHAEL GALESI,

Defendants-Appellants,

and

FIRST NATIONAL BANK OF OKLAHOMA CITY,

Defendant.

Nos. 01-5119 & 02-5021

(Filed Apr. 24, 2003)

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OKLAHOMA
(D.C. No. 83-CV-179-E)

R. Thomas Seymour (C. Robert Burton with him on the briefs), Seymour Law Firm, Tulsa, Oklahoma, for Defendants-Appellants.

David Feinsilver, The Feinsilver Law Group, P.C., Millburn, New Jersey, for Plaintiff-Appellee.

Before **TACHA**, Chief Judge, and **BALDOCK** and **MURPHY**, Circuit Judges.

BALDOCK, Circuit Judge.

Defendants appeal the district court's entry of a $1.1 million default judgment. The district court entered default as a discovery sanction after finding Defendants repeatedly, willfully, and in bad faith failed to comply with discovery orders. On appeal, Defendants assert the district court was without jurisdiction to enter a default judgment. Defendants also raise numerous additional challenges to the district court proceedings. We have jurisdiction pursuant to 28 U.S.C. § 1291.[1] We affirm the judgment and

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[1] We *sua sponte* filed an order to show cause why the appeal should not be dismissed for lack of subject matter jurisdiction. Specifically, we questioned whether the district court's judgment order was a final decision because the order did not resolve certain non-party claims

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damage award, but remand with instructions to recalculate the prejudgment interest award.

I.

Plaintiff Bernard Olcott, an investor in oil drilling and exploration limited partnerships, filed a complaint against Defendants in 1982 alleging federal securities law violations and various state law tort, fraud and breach of contract claims.[2] The claims arose out of Defendants' solicitation, sale and operation of oil tax shelter limited partnership units between 1976 and 1979. Plaintiff's suit sought damages and rescission of the investment contracts. In February 1986, after unsuccessfully attempting to employ more traditional discovery motions, Plaintiff

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asserting ownership over funds held in escrow. *See* 28 U.S.C. § 1291. The parties' briefs explained and further review confirmed that the unresolved claims affect the court's execution of the judgment rather than the merits of the judgment order. The district court's retention of ministerial matters concerning execution of its judgment is a collateral matter and does not deprive us of jurisdiction to hear the appeal. *See Copeland By and Through Copeland v. Toyota Motor Sales U.S.A., Inc.*, 136 F.3d 1249, 1252 (10th Cir. 1998) (Generally, a district court decision is final when the court has rendered a decision that ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.). The district court's judgment order is a final decision and this Court has jurisdiction to hear the appeal.

[2] This case is before us for the third time. A detailed factual description of the parties, claims and lengthy procedural history appears in *Olcott v. Delaware Flood Co.*, 76 F.3d 1538 (10th Cir. 1996) (hereinafter "*Olcott II*"). We limit our current discussion to facts relevant to the issues before us. Our factual recitation is complicated somewhat by the inaccurate legal terminology used in the district court proceedings.

filed a motion to compel Defendants to render an accounting of all partnership assets and income. On March 4, in exchange for the court's postponement of the jury trial scheduled to begin March 17, Defendants consented to entry of an accounting order requiring them to provide Plaintiff within six months "a full, complete, meaningful, and formal accounting . . . setting forth all items of contribution, income, and expense as well as the disposition of all assets and monies. . . ."

Defendants subsequently submitted three accountings. After each submission, Plaintiff challenged the sufficiency of the accounting. The court-appointed accounting expert also found each of the submitted accountings wholly inadequate. The court held an evidentiary hearing after each submission and, after each hearing, concluded the submitted accounting did not comply with the court's accounting orders. After each hearing, the court ordered Defendants to file a supplemental accounting.

After the third submission, and a delay of almost four years, the court concluded Defendants' failure to comply was willful and in bad faith. The court partially based its conclusion on the testimony of two of Defendant Michael Galesi's former attorneys. Each testified Galesi agreed to provide an accounting solely to obtain a continuance and never had any intention of complying with the court's accounting order. Counsel also testified that Galesi still had no intention of complying with the court's order and would rather "take his chances" than provide the accounting. Plaintiff also introduced evidence that none of Defendants had requested bank records or made any other effort to produce an accounting in compliance with the court's order. As a result of the willful discovery violations, the court entered an order of default on February 8, 1990. *See*

Fed. R. Civ. P. 37(b)(2); Fed. R. Civ. P. 55(a). In its order, the court stated:

> This court must order a sanction appropriate to the severity of Defendants' abuse of the legal process. Plaintiff is entitled to a judgment against the Defendants, jointly and severally, for his investment of $1.9 million less any portion of those funds which Defendants can establish were utilized for legitimate purposes under the terms and provisions of the limited partnership agreements. There will be a trial at which the burden will be on the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate business purposes under the terms of the agreements among the parties.[3]

The court also ordered Defendants to comply with its prior accounting order by correcting the deficiencies identified by the court's expert.

Following the court's entry of default, Defendants filed a summary judgment motion asserting the statute of limitations barred Plaintiff's federal securities act claims. The district court ultimately dismissed Plaintiff's federal claims on statute of limitations grounds.[4] The court also

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[3] Although the court termed the anticipated proceeding a "trial," the proceeding described is not a trial on the merits but a hearing to determine the amount of damages. *See* Fed. R. Civ. P. 55(b)(2). Entry of default precludes a trial on the merits. *See Jackson v. FIE Corp.*, 302 F.3d 515, 524 (5th Cir. 2002).

[4] See *Olcott II*, 76 F.3d at 1542-43 for a discussion of the Supreme Court decision and subsequent Congressional actions that changed the law and prompted the district court to consider Defendants' summary judgment motion despite its prior entry of default. The court properly

(Continued on following page)

dismissed Plaintiff's state law claims, concluding that it did not have jurisdiction after dismissing the federal claims. In the same order, without referring to its prior entry of default, the court sanctioned Defendants for their failure to comply with discovery orders by ordering Defendants to pay $402,527.98 in attorneys' fees and accounting expenses. Plaintiff appealed the dismissal of his federal and state claims and sought enforcement of the order entering default. Defendants cross-appealed the imposition of the monetary sanction.

On appeal, this Court affirmed dismissal of Plaintiff's federal securities act claims with respect to the 1976, 1977 and 1978 partnership interests, but reversed and remanded for reconsideration the district court's dismissal of the 1979 securities act claims and all pendant state law claims. *Olcott II,* 76 F.3d 1538 (remanding Plaintiff's securities act claims for further factual findings and remanding Plaintiff's pendant state claims with instructions to conduct the appropriate death knell analysis). *Olcott II* also affirmed the district court's imposition of the monetary sanction, but declined to rule upon the merits of the default order after concluding the court's entry of default was not a final determination. *Id.* at 1558-59. In *Olcott II,* we assumed the district court intended to "abandon" its entry of default when it entered an order dismissing all claims without entering judgment on the default

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could consider Defendants' motion because, although the court entered an order of default pursuant to Fed. R. Civ. P. 55(a), the court had not yet entered *judgment* by default pursuant to Fed. R. Civ. P. 55(b). *See Hunt v. Inter-Globe Energy, Inc.,* 770 F.2d 145, 147 (10th Cir. 1985) (discussing distinction).

pursuant to Fed. R. Civ. P. 55(b). *Id. Olcott II* expressly instructed the district court that it could revisit the issue on remand: "If the court ultimately revives Mr. Olcott's cause of action based on his 1979 investment, the court could take the opportunity to revisit the appropriateness of a default judgment at that time." *Id.* at 1559.

On remand, the district court again dismissed as time barred the federal securities claims based on Plaintiff's 1979 investment, but elected to retain pendant jurisdiction over Plaintiff's state law tort, fraud and breach of contract claims. The court also indicated its intent to apply the default entered prior to the appeal. At a January 1998 conference, the court specifically ruled that Plaintiff's remaining claims would "merge"[5] into the default, stating: "I further find and order that [Plaintiff's remaining claims] merged into the 1.9 million dollar judgment entered by this Court."

In a February 4, 1998 order, the district court dismissed many of Plaintiff's state law claims. The court also ruled Plaintiff's remaining fraud and breach of contract claims would not be tried during the set-off hearing:

> The primary issue raised by the motions for summary judgment is whether Plaintiff is entitled to pursue his state law claims and receive the benefit of the $1.9 million default judgment he has previously been awarded. Plaintiff has

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[5] The district court used the term "merge" to describe its decision to enter default on Plaintiff's state law claims. *See supra,* f.n. 7. The district court "merged" Plaintiff's state law claims into the prior default order rather than issuing an order formally entering default on these claims.

> stated both at the preliminary trial conference and at status conferences, that he wishes to accept the $1.9 million default judgment, but that he wishes also to be able to put on evidence for his fraud case as well. Plaintiff concedes that damages are the same, but argues that proving the fraud case is necessary because he may incur problems proving his case if the default judgment is ultimately reversed. This is not sufficient reason to allow Plaintiff to put on evidence to prove a fraud claim when Plaintiff has already received a judgment in his favor entitling him to the same damages. In the interest of efficiency and judicial economy, the trial of this matter is limited to the issues encompassed by the default judgment previously entered.[6]

The court conducted a set-off hearing to establish and quantify Defendants' entitlement to credits against the default. Defendants had the burden of establishing their entitlement to credits by producing an accounting that complied with the court's prior accounting orders. The court limited its consideration of Defendants' evidence to accounting materials directly tracing Defendants' use of Plaintiff's funds. The court did not permit Plaintiff to put on evidence related to his fraud or contract claims.

On June 6, 2001, after a three-day hearing, the court entered judgment in favor of Plaintiff in the amount of $1,077,014.70 plus interest. The court specifically found

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[6] As previously noted, the court had not previously entered a "default judgment" pursuant to Fed. R. Civ. P. 55(b), but had entered an order of default pursuant to Fed. R. Civ. P. 55(a). The proceeding to quantify damages was not a "trial" but a hearing pursuant to Fed. R. Civ. P. 55(b)(2).

Defendants failed to cure the deficiencies in the accounting. With the exception of certain Plaintiff-stipulated credits, the court ruled Defendants failed to establish entitlement to any credits against the default. The court subsequently entered an order quantifying the prejudgment interest award and awarding attorneys' fees and costs.

II.

In this appeal, Defendants first assert the district court was without jurisdiction to conduct a set-off hearing or to enter the final judgment order because the court had previously dismissed all substantive claims. Whether the district court had jurisdiction is a legal question we review de novo. *Kunkel v. Continental Casualty Co.*, 866 F.2d 1269, 1273 (10th Cir. 1989).

A.

In its pre-trial order, the district court summarized its prior ruling limiting the set-off hearing to issues encompassed by the order entering default:

> The Court further held [in its February 4, 1998 Order] that "in the interest of efficiency and judicial economy the trial of this matter is limited to the issues encompassed by the default judgment previously awarded" by the February 8, 1990 Order. Hence, Plaintiff's claims for common law fraud, breach of contract, rescission, negligence, mismanagement, malfeasance, misfeasance, partnership waste, breach of fiduciary duties and interference with business and investment objectives, were *dismissed.*

(emphasis added). Defendants rely on this single statement in the pre-trial order to argue the district court dismissed Plaintiff's state law fraud and contract claims. The district court's description of its prior ruling was an unfortunate misstatement. The February 4, 1998 order clearly did not dismiss Plaintiff's fraud and breach of contract claims. Instead, the order noted that these claims were still viable but that, in the interest of judicial economy, "Plaintiff [would not be allowed] to put on evidence to prove a fraud claim when Plaintiff has already received a judgment in his favor entitling him to the same damages." The district court never dismissed Plaintiff's fraud and breach of contract claims.

Reading the pre-trial order as a whole clarifies that "in the interest of efficiency and judicial economy" the district court "merged" these claims into the default order, in effect placing all substantive matters on hold pending resolution of the default order.[7] The pre-trial order states that jurisdiction is predicated on the claims Defendants allege the court dismissed: "Jurisdiction is predicated upon

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[7] The district court "merged" Plaintiff's state law claims into the prior default order rather than issuing a second order formally entering default on these claims. *See* Fed. R. Civ. P. 55(a). The court's failure to formally enter default is procedurally incorrect, but the court's intent to resolve the accounting matter rather than try Plaintiff's claims on the merits was evident. Although the court did not use the correct legal terminology, the court made its intention perfectly clear at every status conference, at the pre-trial conference, and during the set-off hearing. The set-off hearing was Defendants' final opportunity to comply with the court's accounting orders. In the event Defendants complied, the court presumably intended to lift the default sanction and proceed to trial on the merits. *See* Fed. R. Civ. P. 55(c). When Defendants failed to comply, the court enforced the sanction by entering judgment. *See* Fed. R. Civ. P. 55(b).

the May 5, 1997 Order of [the Court], wherein this Court ruled that this Court would retain jurisdiction over Plaintiff's pendant state claims." The order also notes: "Although Mr. Olcott would be willing to accept a final default judgment for the amount of his investment plus prejudgment interest less his actual return on investment, he has *not* consented to forego his breach of contract and fraud claims. . . ." (emphasis in the original).

In transcripts of hearings, the court also repeatedly notes that Plaintiff's claims were "merged" into the default rather than dismissed. At a January 1998 conference, the court specifically ruled that Plaintiff's remaining claims had merged into the default judgment: "I further find and order that the contract claims of Plaintiff *merged* into the 1.9 million dollar judgment entered by this court." During the August 10, 2000 pretrial conference, at which the parties reviewed the pretrial order in question, the district court repeatedly reaffirmed the merger of Plaintiff's breach of contract and fraud claims into the sanction judgment: "This is not a contract case. The contract case and the fraud case *merged* into the Court's $1.9 million judgment."

At the set-off hearing, the district court instructed counsel that Plaintiff's fraud claims would be addressed, if necessary, following the court's resolution of the default judgment proceedings. Finally, in its June 6, 2001 judgment order, the court stated:

> On remand [from the appellate court] this Court granted summary judgment on a number of claims and held that the remaining claims *merged* into the $1.9 million default judgment award entered in 1990.

(emphasis added). Despite the misstatement in the pre-trial order, the parties were well aware that Plaintiff's state law fraud and breach of contract claims remained viable. The record does not support Defendants' argument that the district court dismissed these claims.[8]

B.

Even if we assume the district court dismissed all substantive claims after entering the order of default, the court retained jurisdiction to enforce the sanction. Defendants argue that constitutional limits on subject matter jurisdiction restrict the district court's authority to enforce a sanction after dismissing all substantive claims. *See* U.S. Const. Art III, § 2. Article III limits the federal courts' subject matter jurisdiction to specifically defined cases and controversies. *Id.* Accordingly, Article III limits a federal court's authority to impose and enforce sanctions when the case or controversy at issue is not properly before the federal courts. *See Hernandez v. Conriv Realty Assoc.,* 182 F.3d 121, 124 (2d Cir. 1999) (holding "where federal subject matter jurisdiction does not exist, federal courts do not have the power to dismiss with prejudice, even as a procedural sanction."); *Ray v. Eyster (In re: Orthopedic "Bone Screw" Prods. Liability Litig.),* 132 F.3d 152, 156-57

[8] Defendants assert Plaintiff agreed to accept a default judgment in lieu of pursuing his fraud and breach of contract claims and thus consented to dismissal of these claims. This clearly is not the case. Plaintiff repeatedly objected to the district court's decision to limit the set-off hearing to issues related to the default judgment. Defendants also note that Plaintiff did not cross-appeal the dismissal of his remaining claims. The district court did not enter an order dismissing the claims. Accordingly, there was no dismissal for Plaintiff to appeal.

(3d Cir. 1997) (same). *But see Allen v. Exxon Corp. (In re The Exxon Valdez),* 102 F.3d 429, 431 (9th Cir. 1996) (default judgment imposed as discovery sanction is enforceable even if it is later determined the court lacked subject matter jurisdiction). If a case or controversy is properly before the federal courts, however, Article III's restriction on federal courts' subject matter jurisdiction is not implicated. *See Willy v. Coastal Corp.,* 503 U.S. 131, 132 (1992) (discussing Article III-based limits on court's ability to impose sanctions where court *never* had subject matter jurisdiction).[9]

Plaintiff's complaint asserted federal securities act claims and pendant state law claims. The district court had original subject matter jurisdiction over the federal claims pursuant to 28 U.S.C. § 1331 and over the state claims pursuant to 28 U.S.C. § 1367(a). Dismissal of a properly pled federal claim does not retroactively deprive

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[9] Although we reach the same result, we recognize our analysis differs from that employed in *Olcott II. Olcott II* similarly affirmed the district court's imposition of a sanction after the district court dismissed all substantive claims. But *Olcott II* affirmed after concluding the sanction was punitive rather than civil in nature. A punitive sanction may be enforced even absent subject matter jurisdiction. *See Willy,* 503 U.S. at 132. *Olcott II* did not decide whether the district court had subject matter jurisdiction when it entered the prior monetary sanction. Because Defendants asserted the district court did not have jurisdiction, and Plaintiff never argued otherwise, *Olcott II* began its analysis with the assumption that the district court did not have subject matter jurisdiction. The *Olcott II* punitive/civil sanction analysis is based on Article III's restrictions on federal jurisdiction. The analysis is properly applied to sanctions entered by a federal court without subject matter jurisdiction. *See id.* The analysis is unnecessary in a case in which the district court had subject matter jurisdiction when it entered a sanction.

the court of subject matter jurisdiction. *See Bell v. Hood,* 327 U.S. 678, 682 (1946) (federal jurisdiction is not defeated by the possibility that complaint fails to state a cause of action on which a plaintiff could actually recover). Nor does the court's dismissal of all substantive claims deprive the court of authority to enforce a previously entered sanction. A district court retains jurisdiction to impose and enforce sanctions until the court enters a final judgment.[10] *See* Fed. R. Civ. P. 54(b) (any order that fails to adjudicate all rights and liabilities does not terminate the action). *See also* 28 U.S.C. § 1291 (limiting appellate jurisdiction, which divests district court of jurisdiction over matters connected to the appeal, to final decisions of the district court). District court proceedings are not final until the district court has rendered a decision that ends the litigation on the merits and leaves nothing for the court to do but execute the judgment. *See Copeland,* 136 F.3d at 1252. This matter was not final until the district court entered its final judgment order quantifying

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[10] Contrary to Defendants' assertions, *Olcott II* does not dictate otherwise. In *Olcott II,* the district court entered an order dismissing all claims and imposing a monetary sanction without referring to its prior entry of default. We found significant the district court's omission of any reference to the entry of default and concluded the district court intended "only to impose the [monetary] sanction [and] to abandon the default judgment as a sanction." *Olcott II* specifically ruled that the district court's judgment order dismissing all claims was a final decision. By contrast, every order the district court entered following remand expressly stated the district court's intent to enforce the entry of default. Defendants allege the district court dismissed Plaintiff's substantive claims in the February 4, 1998 order. Although we find otherwise, even were this the case the order is not final in that it expressly contemplates subsequent proceedings on the default sanction. *See Copeland,* 136 F.3d at 1252 (discussing finality of district court decisions).

Plaintiff's damage award following the set-off hearing. The February 4, 1998 order, which Defendants allege dismissed Plaintiff's remaining substantive claims, expressly contemplates further proceedings before the district court. Accordingly, the order did not constitute a final decision and did not divest the district court of jurisdiction to enforce the sanction.

In sum, the record does not support Defendants' argument that the district court dismissed all of Plaintiff's substantive claims. But even assuming the district court inadvertently dismissed all substantive claims after entering default, the court expressly retained jurisdiction to enforce the sanction. The district court proceedings were not final, and the court had jurisdiction to enforce its prior sanction.

III.

Defendants next assert the district court violated their constitutional right to a jury trial. The district court determined that the set-off hearing, limited to ascertaining Defendants' compliance with court discovery orders, required resolution of equitable rather than legal issues. Accordingly, the court concluded Defendants did not have a right to a jury and ruled that the set-off hearing would be tried before the bench. Defendants assert they were entitled to a jury pursuant to Fed. R. Civ. P. 55(b)(2) and the Seventh Amendment of the Constitution. Following the entry of default, Fed R. Civ. P. 55(b)(2) authorizes the district court to conduct an evidentiary hearing to determine the amount of damages. The Rule does not contain an inherent jury requirement, but preserves the right to a jury "when and as required by any statute of the United

States." Defendants assert the Seventh Amendment provides the right to a jury because Plaintiff's complaint sought money damages.

Defendants would have been entitled to a jury at a trial on the merits of Plaintiff's legal claims. But the set-off hearing was not a trial on the merits of these claims. Instead the district court held the hearing following its entry of default for Defendants' willful discovery violations. *See* Fed. R. Civ. P. 37(b)(2). Defendants do not have a constitutional right to a jury trial following entry of default. *See Goldman, Antonetti, Ferraiuoli, Axtmayer & Hertell v. Medfit Int'l., Inc.,* 982 F.2d 686, 692 (1st Cir. 1993) ("Following the entry of default under Fed. R. Civ. P. 37(b)(2), a party does not have a right to a jury trial under either Fed. R. Civ. P. 55(b)(2) or the Seventh Amendment.") (quoting *Adriana Int'l Corp. v. Thoeren,* 913 F.2d 1406, 1414 (9th Cir. 1990)); *Dierschke v. O'Cheskey,* 975 F.2d 181, 185 (5th Cir. 1992) ("in a default case neither the plaintiff nor the defendant has a constitutional right to a jury trial on the issue of damages"); *Adriana Int'l Corp.*, 913 F.2d at 1414 (citing *Henry v. Sneiders,* 490 F.2d 315, 318 (9th Cir. 1974)). *See also Sells v. Berry,* 24 Fed.Appx. 568, 571 (7th Cir. 2001). Accordingly, the district court did not err in conducting the set-off hearing without a jury.

IV.

Defendants also raise two merit-based challenges to the district court's final default judgment order. "Decisions to enter judgment by default are committed to the district court's sound discretion, and our review is for an abuse of discretion." *Dennis Garberg & Assocs. v. Pack-Tech Int'l Corp.,* 115 F.3d 767, 771 (10th Cir. 1997). We will not

disturb the court's decision without a clear showing that the decision was based on a clearly erroneous factual finding or that it manifests a clear error of judgment. *See Cartier v. Jackson,* 59 F.3d 1046, 1048 (10th Cir. 1995).

First, Defendants assert that the evidence introduced at the set-off hearing does not support the court's final judgment. The court's February 8, 1990 order entering default stated that Plaintiff was entitled to reimbursement of the $1.9 million he invested in the partnership interests, but that the damage award would be reduced to the extent Defendants could establish "to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate business purposes." The court later clarified that evidence in support of any claimed offset was limited to "direct proof" in the form of an accounting directly tracing Defendants' use of Plaintiff's funds. Defendants failed to introduce any evidence in the form required.

Nonetheless, Defendants claim the evidence introduced at the set-off hearing established that Plaintiff's entire contribution was utilized for legitimate business purposes under the terms of the contract. Defendants' argument requires this Court to interpret the terms of the underlying investment contract. As such, it is a merits argument foreclosed by the district court's default judgment. *See Jackson,* 302 F.3d at 525 ("[D]efendant by his default, admits the plaintiff's well-pleaded allegations of fact, is precluded from challenging those facts by the judgment, and is barred from contesting on appeal the facts thus established.") (internal quotation marks and

citations omitted). The district court expressly instructed the parties that it would not hear arguments based on the contractual provisions in the underlying agreements.[11] After the entry of default, Defendants were not entitled to raise merits-based argument before the district court. *Id.* The district court's entry of a default judgment precludes Defendants from raising such arguments on appeal. *Id.*

Defendants also assert the district court erred in finding the accounting presented at the set-off hearing was not in substantial compliance with the court's prior accounting orders. Whether the accounting presented complied with the court's accounting orders is a factual finding to which this Court gives substantial deference. *Olcott II,* 76 F.3d at 1558. We will not disturb the court's factual finding unless clearly erroneous. *See Cartier,* 59 F.3d at 1048.

Plaintiff's accounting expert testified on the sufficiency of the accounting and delineated numerous grounds in which Defendants' submission failed to comply with the court order. Where a factual finding rests upon the credibility of a witness, Rule 52(a) requires that this Court give

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[11] The district court properly refused to consider evidence Defendants introduced in an effort to defend the contract claims on the merits. After an entry of default, a defendant cannot defend a claim on the merits. *See Jackson,* 302 F.3d at 524 ("A default judgment is unassailable on the merits."); *Adriana Int'l Corp.,* 913 F.2d at 1414 ("[A] default judgment generally precludes a trial of the facts except as to damages."). Defendants argue that the set-off hearing was, in reality, a trial on the merits. But, as the district court repeatedly emphasized, the purpose of the set-off hearing was to force Defendants to produce a full accounting and, failing that, to award Plaintiff damages based on the willful discovery violation; it was not a trial on the merits of the underlying claims. *See* Fed. R. Civ. P. 37(b)(2); Fed. R. Civ. P. 55.

even greater deference to the findings of the trial judge. *Id.* Substantial evidence exists to support the court's determination that the accounting presented was not in substantial compliance with the court's prior orders. Accordingly, this claim of error also is without merit.

V.

Finally, Defendants challenge the district court's prejudgment interest award. This court reviews the district court's decision to award prejudgment interest for an abuse of discretion and will reverse only if we are left with a definite conviction that the court clearly erred in its judgment. *See Suiter v. Mitchell Motor Coach Sales, Inc.*, 151 F.3d 1275, 1288 (10th Cir. 1998).[12]

The district court entered default judgment on Plaintiff's pendant state law claims. Where state law claims are before a federal court on supplemental jurisdiction, state law governs the court's award of prejudgment interest. *Mills v. River Terminal Ry. Co.*, 276 F.3d 222, 228 (6th Cir. 2002). The district court applied Oklahoma state law. But, as we clarified in *Olcott II*, 76 F.3d at 1550, the relevant law in this case is the law of the transferor court. Plaintiff originally filed this action in the District of New Jersey and the pendant state claims alleged violations of New Jersey law. Accordingly, New Jersey law, rather than Oklahoma law, governs.

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[12] Defendants first assert prejudgment interest cannot be awarded on a sanction. As a sanction, the district court entered a default judgment. The court did not abuse its discretion in awarding prejudgment interest on a default judgment.

Under New Jersey law, a court may award prejudgment interest in its discretion, and the court's exercise of its discretion will not be disturbed on appeal unless it represents "a manifest denial of justice." *Liberty Lincoln-Mercury v. Ford Motor Co.,* 134 F.3d 557, 574 (3d Cir. 1998) (applying New Jersey law). A court clearly may award prejudgment interest on tort claims, including fraud claims. *See* New Jersey Rule 4:42-11. A court also may award prejudgment interest on contract claims. *Cooper Dist. Co., Inc. v. Amana Refrigeration, Inc.,* 63 F.3d 262, 284 (3d Cir. 1995) (applying New Jersey law); *Meshinsky v. Nichols Yacht Sales, Inc.,* 541 A.2d 1063, 1070 (N.J. 1988). "Moreover, the rule that limited prejudgment interest awards to cases where damages were liquidated or clearly ascertainable in advance has been significantly eroded." *Meshinsky,* 541 A.2d at 1070. Today, the purpose of an award of prejudgment interest is "to indemnify the claimant for the loss of what the moneys due him would presumably have earned if the payment had not been delayed." *Cooper Distrib. Co.,* 63 F.3d at 284. The primary consideration is whether defendants, rather than the plaintiff, had use of the funds in question, not whether the amount in controversy is clearly fixed. *See id.*

Given the district court's factual findings and the lengthy delays caused by Defendants' willful failure to comply with discovery orders, the district court did not abuse its discretion in awarding prejudgment interest. But the district court did err in applying Oklahoma rather than New Jersey law. Accordingly, we affirm the court's award of prejudgment interest, but remand for recalculation based on New Jersey Rule 4:42-11(b). *See North Bergen Rex Transp., Inc.,* 730 A.2d at 851 (reaffirming that N.J.R. 4:42-11(b) governs the award of prejudgment

interest on contract as well as tort claims). *See also Liberty Lincoln-Mercury,* 134 F.3d at 574 (same).

VI.

Plaintiff's claims have been pending before the federal courts for over twenty years. Defendants willful refusal to comply with the district court's discovery orders is a significant source of the delay. Enough is enough. We AFFIRM the June 6, 2001 judgment order and damage award. We also AFFIRM the district court's award of prejudgment interest, but REMAND with instructions to recalculate the prejudgment interest award pursuant to New Jersey Rule 4:42-11(b).[13]

SO ORDERED.

[13] Defendants' Motion to Strike Portions of Appellee's Answer Brief is denied.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff, vs. DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; LAYTON OIL COMPANY, a Kansas Corporation, WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH, DELAWARE FLOOD COMPANY 1977 EH, DELAWARE FLOOD COMPANY 1978 FH, DELAWARE FLOOD COMPANY 1979 LTD., limited partnerships under the laws of Oklahoma; and MICHAEL GALESI, Defendants.	)	Case No.83-C-179-E

JUDGMENT

(Filed June 6, 2001)

In accord with the Findings of Fact and Conclusions of Law filed this date, the court hereby enters judgment in favor of the Plaintiff, Bernard Olcott, and against the Defendants, Michael Galesi, William douglas Layton, Layton Oil Company, a Delaware corporation, 1976 D-H Program, 1977 E-H Program, 1978 F-H Program, 1979 Ltd. and Delaware Flood company, an Oklahoma limited

partnership, in the amount of $1,077,014.70 plus interest.

DATED this 6th day of JUNE, 2001.

/s/ James O Ellison
JAMES O ELLISON, SENIOR
JUDGE
UNITED STATES DISTRICT
COURT

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff, vs. DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; LAYTON OIL COMPANY, a Kansas Corporation, WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH, DELAWARE FLOOD COMPANY 1977 EH, DELAWARE FLOOD COMPANY 1978 FH, DELAWARE FLOOD COMPANY 1979 LTD., limited partnerships under the laws of Oklahoma; and MICHAEL GALESI, Defendants.	Case No. 83-C-179-E (Filed Jun. 6, 2001)

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This is an action arising out of the solicitation, sale and operation of oil tax shelter limited partnership units purchased by Plaintiff Bernard Olcott, a limited partner, from the relevant Defendants in 1976, 1977, 1978 and 1979. Plaintiff originally brought claims for securities fraud, common law fraud, breach of contract, rescission, restitution, negligence, mismanagement, malfeasance, misfeasance, partnership waste, breach of fiduciary duties and interference with business and investment objectives. This matter was initially dismissed on statute of limitations grounds, and then reversed in part and remanded by

the appellate court. On remand this Court granted summary judgment on a number of the claims and held that the remaining claims merged into the $1.9 million default judgment award entered in 1990.

Therefore the only issue before the Court for trial is framed by the Court's 1990 Order entering a default judgment against defendants. In that Order, dated February 8, 1990, the Court found that:

> Plaintiff is entitled to a judgment against the Defendants, jointly and severally, for his investment of 1.9 million dollars less any portion of those funds which Defendants can establish were utilized for legitimate purposes under the terms and provisions of the Limited Partnership Agreements. There will be a trial at which the burden will be upon the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties.

The Court made it clear that the standard of proof for a set-off of default judgment is that of a meaningful accounting of the use made of Mr. Olcott's investment. Under the terms of the default judgment, the defendants were required to prove any set-off with accounting testimony and monetary proofs.

The Court, upon consideration of the evidence presented at trial, the briefs submitted, and arguments of counsel, enters the following findings of fact and conclusions of law:

Findings of Fact:

1. The parties are designated as follows:

   A. Plaintiff, Bernard Olcott, an engineer and attorney;

   B. Defendants, Michael Galesi, William Douglas Layton, Layton Oil company, a Delaware Corporation, 1976 D-H Program, 1977 E-H Program, 1978 F-H Program, 1979 Ltd and Delaware Flood Company, an Oklahoma limited partnership.

2. Olcott invested $350,000, $500,000, $550,000 and $500,000, respectively, in the 1976, 1977, 1978 and 1979 oil and gas drilling programs of Defendant Delaware Flood Company, by making capital contributions to limited partnerships formed to perform the four Programs.

3. Each of the four Programs involved an operating agreement between Defendant Delaware Flood Company, wherein Defendant Layton Oil Company was to serve as operator of the oil and gas properties underlying the four programs.

4. Each of the four Programs involved a turnkey drilling contract between Defendants Delaware Flood Company and Layton Oil Company as drilling contractor.

5. Defendants stipulated that none, or virtually none, of the investment of the limited partners (which were paid to Layton Oil Company in payment of the obligations under the turnkey drilling contracts) were used by Layton Oil Company on the wells in the four Programs, but were placed in the general funds of Layton Oil company and used in the conduct of Layton Oil company's business.

6. Charles Underwood, CPA, and former controller for Layton Oil Company, admitted that very little if any of the monies put up by the limited partners was utilized by the Defendants for the subsequent performance of turnkey contract work.

7. This case came on for trial pursuant to the court's having awarded Plaintiff a default judgment of $1.9 million dollars, subject to Defendants' ability to show legitimate use of plaintiff's contribution to the limited partnerships and further subject to Defendants' completing the accounting they were required to provide. The court's Order of February 8, 1990, attached hereto as Exhibit "A" is incorporated herein as findings of fact.

8. Much of Defendants' evidence at trial went to their position that "Layton Oil Company fulfilled its obligations under the four turnkey drilling contracts on the four Programs."

9. Defendants also put on evidence that the drilling work required to be performed on the 1976, 1977, 1978 and 1979 Programs was performed. Defendants also put on evidence as to the total cost of drilling each of the Programs, and multiplied the drilling cost for each program by the percentage interest that Plaintiff had in that particular Program. As a result, Defendants argued that the total expenditure of Layton Oil Company attributable to Olcott's interest in the four Programs is as follows: 1) 1976 Program – $323,787; 2) 1977 Program – $500,000; 3) 1978 Program – $545,004; and 4) 1979 Program – $337,035. This results in a total expenditure of

Layton Oil Company attributable to Olcott's interest in the four Programs in the amount of $1,705,826.

10. Evidence was put on by Defendants regarding tax benefits enjoyed by Mr. Olcott as a result of his investments in the 1976, 1977, 1978 and 1979 Programs.

11. The Court has ruled previously, and still finds, that tax benefits are not the type of evidence that can be considered as a set-off to the default judgment.

12. Plaintiff stipulated that Olcott received $623,161 in partnership distributions for the four Programs. The Court finds that Defendants are entitled to a credit in that amount. Although Defendants presented some evidence that the amount received by Olcott was approximately $640,000, the Court does not find that sufficient documentary evidence was presented to support the greater number.

13. Defendants also put on evidence that Olcott received $271,152.00 ($208,983.00 plus interest in the amount of $62,168.96) for the exercise of a "put" on the 1977 program. Although Mr. Olcott argues that the monies from the "put" are unrelated and have nothing to do with his entitlement to recover on this court's sanction judgment, the Court finds that the monies do reasonably relate to a return on Mr. Olcott's investment and that Defendants are entitled to a credit for his net recovery.

14. Although neither Mr. Olcott nor his attorney nor his accountant were able to supply exact numbers for the costs ans [sic] attorneys fees incurred in pursuing the recovery on exercising the

"put," the Court accepts as reasonable the estimate that the costs would have been approximately $2,500 and the attorney fee would have been a contingency fee of one third of the net recovery. Defendants are therefore entitled to a credit in the amount of $199,824.30, the amount actually received by Mr. Olcott.

15. Defendants have failed to render an accounting and have not accounted for the specific use of Mr. Olcott's moneys.

16. Any findings of fact that are actually conclusions of law should be considered as such.

Conclusions of Law

17. With the exception of the credits for monies actually received by Mr. Olcott, the Defendants have failed to meet the "direct proof" requirement as to credits against the $1.9 million judgment. Specifically, the court rejects, as it has done before in its rulings on Defendants' motion for summary judgment and motion to reconsider, Defendants' evidence regarding its fulfillment of its obligations under the four turnkey drilling contracts on the four programs as proof of any credit on the judgment. In light of the stipulation at finding of fact #5, above, such proof simply does not satisfy the terms of the sanction levied by the Court in its order of February 8, 1990.

18. The Defendants have substantially failed to cure the deficiencies in the accounting cited by this Court in its February 8, 1990 Order.

19. The defendants are entitled to credits against the default judgment in the amount of $623,161.00

and $199,824.30, for a total default judgment in the amount of $1,077,014.70.

20. Consistent with the terms of the February 8, 1990 Order, any additional sanctions for fees expenses and costs will be addressed separately upon proper application or motion.

21. In light of the Court's ruling in this matter, Defendants' Motion and Brief to Strike Portions of Plaintiff's Proposed Findings of Fact and Conclusions of Law (docket #1065) is DENIED as MOOT.

22. Any conclusions of law that are actually findings of fact should be considered as such.

IT IS SO ORDERED THIS 6TH DAY OF JUNE, 2001.

/s/ James O. Ellison
JAMES O. ELLISON,
SENIOR JUDGE
UNITED STATES
DISTRICT COURT

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff, vs. DELAWARE FLOOD COMPANY, INC., et al., Defendants.	)	No. 83-C-179-E (Filed Feb. 8, 1990)

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Court in this order addresses Plaintiff's Second Renewed Motion for Sanctions including the entry of default judgment against Defendants.

In addressing the issues raised by the motion the Court considers the entire record in this case including the record before the United States Magistrate.

FINDINGS OF FACT

1. The parties are designated as follows:

   A. Plaintiff, Bernard Olcott;

   B. DFC, Delaware Flood Company, an Oklahoma general partnership;

   C. L & G, L & G Petroleum Company;

   D. S. Layton, Stephen Layton;

   E. D. Layton, William D. Layton;

Exhibit "A"

F. C. Layton, Clyde Layton;

G. "DFC-1976", Delaware Flood Company 1976-DH Program Ltd., an Oklahoma limited partnership;

H. "DFC-1977", Delaware Flood Company 1977-EH Program Ltd., an Oklahoma limited partnership

I. "DFC-1978", Delaware Flood Company 1978-FH Program, Ltd., an Oklahoma limited partnership;

J. "DFC-1979", Delaware Flood Company 1979-FH Program, Ltd., an Oklahoma limited partnership;

K. "The Subject Limited Partnerships", DFC-1976, DFC-1977, DFC-1978 and DFC-1979 collectively;

L. "Galesi", M. Michael Galesi;

M. "Equinox", Equinox Oil Company, an Oklahoma corporation;

N. "Finoco", Finoco, Inc., a New Jersey corporation; and

O. "LOC", Layton Oil Company.

2. Plaintiff and Galesi are both residents and citizens of the State of New Jersey.

3. D. Layton is a resident and citizen of the State of Kansas.

4. LOC was organized in the State of Delaware and has filed Articles of Domestication in the State of Oklahoma.

5. Equinox is the operator of the oil leases of the Limited Partnerships. Galesi owns Equinox.

6. The investments made by Plaintiff in the limited partnership interests were:

   a. DFC 1976, $350,000.00;

   b. DFC 1977, $500,000.00;

   c. DFC 1978, $550,000.00;

   d. DFC 1979, $500,000.00.

7. LOC was the turnkey drilling contractor for the Limited Partnership leases.

8. L & G, a non-party, is a general partnership formed in 1977 whose present partners are Galesi (85%) and Steven Layton (15%). The majority of the properties contributed to the programs were assigned to DFC by L & G.

9. DFC acts as the general partner of the limited partnership programs. At a time subsequent to Plaintiff's investment in the programs Defendant Galesi became the general partner of DFC with 85% ownership. The operation of the limited partnerships was apparently delegated by DFC to LOC and then to Equinox which is 100% owned by Defendant Galesi.

10. LOC went out of business in December 1983 and assigned all of its properties to Defendant Galesi in 1984. These assets were used by Galesi for the purpose of forming and operating Equinox which operates out of LOC's former facilities. D. Layton, former president of LOC, is now employed as a consultant to Equinox and L & G.

11. Galesi originally solicited Plaintiff's limited partnership investments.

12. Galesi through his counsel consented to render the accounting which is the subject matter of this motion. The sole issue appropriate for determination by the Court at this juncture is whether the Defendants have failed to comply with the agreed order for accounting and, if so, whether that failure is so purposeful as to justify the ultimate sanction of default judgment or a lesser sanction.

13. Plaintiff on February 8, 1986 filed a motion for an order compelling the Defendants to render a formal accounting.

14. The trial by jury scheduled for March 17, 1986 was stricken at a pretrial conference held on March 4, 1986 when the parties entered into a consent stipulation and order which was signed on March 18, 1986 and which order provided:

    a. The defendants shall, at their own expense, within six months of March 4, 1986, furnish plaintiff with a full, complete, meaningful, and formal accounting of all of the financial affairs of the . . . [partnerships], setting forth all items of contribution, income, and expense as well as the disposition of all assets and monies . . . including a full and complete accounting for all monies paid by each of the partnerships under the turnkey drilling contracts . . .;

    b. Said accounting shall be . . . set up to show, among other things, all charges and allowances, assets on

hand as of the date of the acquisition thereof, and the date of the account, and the changes made in the assets during the period of the account. The receipts and disbursements on account of corpus and income shall be stated separately;

c. The plaintiff shall have the right to designate and retain an accountant of his own selection, to whom all books, records, materials, information, and supporting vouchers, etc., (being utilized by the defendants in the rendering of their accounting) shall be made available on a regular basis, to supervise the accounting; and

d. The defendants shall, within ninety (90) days of March 4, 1986, file with this Court, and serve upon the plaintiff, an interim status report, setting forth the precise status of defendants' accounting efforts, including, but not limited to, those efforts which have been accomplished, that which remains to be accomplished, and the general fiscal condition of each of the defendant limited partnerships.

15. Defendants consulted with their attorneys, consented to and authorized the stipulation and order set forth in the preceding paragraph.

16. The purpose of the consent to render an accounting was to obtain a continuance of the March 17, 1986 trial date. At the time of the stipulation

and order for the accounting Galesi was in charge of the Defendants' business activities. Defendants fully understood the scope and intent of the Court's order of accounting. Defendants requested and obtained six months within which to prepare the accounting.

17. Extensions of time were applied for by Brad Keller, Esq. of the Hall Estill law firm, counsel for the Defendants, one of which was "necessitated by Defendants' lack of assistance and cooperation in aiding Defendants' counsel in preparing said report . . ." Counsel for the Defendant withdrew from the case because of client lack of response to the orders of this Court.

18. Defendants did nothing to comply with the order of March 18, 1986 until December 19, 1986.

19. Jonathan Alden, Esq. of Hall Estill, former counsel for Mr. Galesi, testified that Galesi told him that he would never give the Plaintiff an accounting. When Alden made specific reference to the requirements of the Court order for an accounting Galesi stated "I'll just have to take my chances."

20. On July 14, 1986 Plaintiff filed a Motion to Enter Default Judgment, to Impose Sanctions, and for other relief. On August 12, 1986 this court directed the Defendants to reply within ten (10) days or be deemed to have confessed under Local Rule 14(a). Thomas Atkinson, newly substituted counsel for the Defendants, on August 22, 1986 filed a brief in opposition to Plaintiff's motion. On September 12, 1986 Defendants filed a "Notice of Filing of Interim Status Report" which was found by the Court on December 19, 1986 not to comply with either the June 4, 1986

interim status report or September 4, 1986 formal accounting requirements and, for these reasons, the December 19, 1986 pretrial conference and January 19, 1987 scheduled trial dates could not go forward. The Court continued the pretrial conference to January 15, 1987. The Court advised the Defendants of the importance of their purging themselves of their failure to meet the requirements of the Court's order to account. The Defendants were directed to file all supporting vouchers with the accounting.

21. The Defendants on January 13, 1987 filed a purported "full, complete, meaningful and formal accounting".

22. The Defendants at the January 15, 1987 pretrial represented to the Court that they had fully complied with its March 18, 1986 order for accounting. Plaintiff disputed the compliance issue.

23. To assist the Court in determining the disputed issue of whether the Court's order had been complied with the Court appointed its own expert, Charles H. Ostrander, C.P.A. Mr. Ostrander reported to the Court on February 10, 1987 that Defendants had failed to comply with the March 18, 1986 stipulation and order, reporting in part as follows:

> . . . The order has not been complied with because the statements presented are incomplete and confusing, important statements and schedules were not submitted, and invoices and documents to support expenditures were not available . . . The statements submitted are

not understandable without supplementary explanation due to the sketchy, summary method of presentation, the classification of items, unreconciled differences . . . additional information which should have been submitted would include statements of financial condition (balance sheets) and changes in financial position, properly detailed and footnoted . . . at a minimum, schedules should have been submitted showing detail of equipment contributions by the general partner with pricing thereon and detail analysis and explanation of all intercompany transactions.

The billing statements from Layton Oil Co. to the partnerships, which comprise all of the expenditures for operation of the oil properties, are not substantiated with any supporting invoices or documents, either in the Exhibits or in the Mid-Continent Tower. Without this supporting information, it is impossible to determine the propriety of charges to the partnerships.

Substantiation of Turnkey Drilling Costs is also deficient in the same respects.

In summation, it appears to me that the *defendants used the narrowest possible interpretation of the Court's order* which did not comply with its intent. (emphasis added).

24. Upon receipt of the Ostrander report the Court set the matter for hearing on March 13, 1987.

25. A full plenary hearing was conducted on the issue of sufficiency of the Defendants' purported accounting. Testimony was taken on March 13, March 16 and March 17, 1987. The Defendants urged that they had fully complied with the order and offered no evidence to demonstrate an inability to comply and made no application for relief from the Court's order.

26. After three full days of testimony the Court found that the accounting did not comply with the Court's order. The Court found that the noncompliance was the result of an attempt to perform the task without allowing sufficient time to do so and denied Plaintiff's application for default as a sanction. The Court ordered as a sanction for the Defendants to pay all of the costs and fees incurred by Plaintiff and the fees and costs of the Court's accounting expert. Defendants were ordered to cure all of the deficiencies and to comply with its March 1986 order for an accounting.

27. On April 16, 1987 at the next scheduled pre-trial conference the Court learned that the deficiencies had not yet been cured by the Defendants, notwithstanding that no application for relief from a three-week time limit had been filed. The Court extended the time by which the accounting would be due, this time until May 11, 1987.

28. The Court on May 5, 1987 entered a Supplemental Consent Order fixing the form and content of the accounting to be submitted for the period ending January 31, 1987 and subsequently

through the period ending February 28, 1987 by May 18, 1987.

29. Defendants on May 12, 1987 filed their accounting. Defendants claimed the accounting to be a full, complete and meaningful accounting in compliance with the Court's orders of March 4, 1986 and May 5, 1987. Plaintiff urged that Defendants had failed to comply with the Court's orders and a second plenary hearing was held. The Court again engaged its expert, Mr. Ostrander, who again reported that Defendants had failed to comply with the Court's orders and provide Plaintiff with a meaningful accounting. The Ostrander report of June 19, 1987 provided in pertinent part:

> "the accounting submitted is nonexistent in the areas of turnkey drilling costs and equipment and leasehold contributions by the general partner, and is in material noncompliance with the order in presentation of intercompany transactions, as well as the other items discussed . . ."

30. The Court set a compliance hearing for August which lasted two full weeks during and between August 17 and 28th, 1987. After extensive written filings by the parties supplementing the testimony presented to the Court, the court on October 14, 1987 entered its order which:

> (a) adjudicated that the Supplemental Accounting furnished by the defendants on May 12, 1987 did not comply with this Court's May 5, 1987 order, in that *inter alia*:
>
> "It does not comply with the requirements set forth throughout the

> Order that the information furnished be supported by source documentation";

(b) expressly found that:

> "It is also clear that source documents were not furnished to Peat Marwick when requested, and that many documents were brought to Tulsa as late as June 3, 1987"; and

(c) once again admonished the defendants that:

> "However the Court is concerned with the integrity of the judicial process. A Court Order is not an instrument to be ignored. Compliance with a Court Order is not optional. The Defendants ... are ordered to ... complete the accounting according to the precise terms of this Court's Order of May 5, 1987. This Second Supplemental Accounting shall be filed on or before January 15, 1988."

31. Defendants thereafter urged misunderstandings of the Court's orders and sought clarification of the Orders. The Court entered an Order December 1, 1987 as follows:

> [t]he Court finds that the Order of May 5, 1987 is not ambiguous. It is clear that Defendants are to fully account for the use made of the turnkey drilling monies contributed by the limited partners ... [t]he principle to be borne in mind is full and complete disclosure of

all monies expended. Defendants contend that the source document requirement is unclear because accountants from Peat, Marwick testified that they relied on source documents. However, not all source documents were supplied to Peat, Marwick, and there was also testimony indicating that Peat, Marwick made the decision not to prepare the accounting from source documents, despite the clear terms of the Order. Therefore the Defendants are directed to the terms of the Order for specific instructions on the use of source documents. The defendants' questions concerning the method for accounting for the ultimate recipients of funds and the use of the intercompany account are governed by the same principles discussed above concerning turnkey drilling costs . . . [t]he ultimate recipients of funds and the use of the funds is to be made clear, and the transactions in the intercompany account must be explained such that Plaintiff can determine what use was made of partnership funds.

* * *

The statement of the Court that "all other specifics of the Order shall be complied with whether or not Defendants' records have previously been kept so that the information is readily available" was a rejection of the excuses offered concerning Defendants' failure to reveal leasehold basis and equipment contributions and has no application to

> the Defendants' defense of lost documents. . . . The evidence produced by the Defendants thus far has established that some documents were destroyed by flood but Defendants have not yet established the particular documents destroyed or lost so as to prove that specific information required by the accounting is no longer available . . .
>
> Defendants remain bound to comply fully with the Order of May 5, 1987. . . .

32. Defendants were required to file their Second Supplemental Accounting by January 15, 1988. On January 6, 1988 they applied for an extension of time alleging "ambiguities" regarding their accounting obligation.

33. The Court on January 19, 1987 directed the Defendant to file a statement regarding alleged ambiguities on or before January 21, 1988 and directed Plaintiff to respond to the same and established a conference with the Court to resolve the issues. Defendants were ordered to file their Second Supplemental Accounting by March 15, 1988.

34. The Court on February 1, 1988 held a telephone conference with counsel and with Defendants Galesi and William Douglas Layton in order to confirm their understanding of their personal obligations to insure compliance with the Court's Orders.

35. On February 4, 1988 the Court in response to Defendants' allegations of ambiguities in the accounting orders again entered an order confirming its earlier orders requiring the Defendants to fully account, among other things, for:

(a) the turnkey drilling monies contributed by the limited partners;

(b) all transfers which were not made pursuant to contemporaneous invoices;

(c) the intercompany account transactions;

(d) the ultimate recipients; and

(e) through the use of source documents.

The Court stated:

> The Court would direct the Defendants to its Order of December 1, 1987 in which the Court made clear that the Defendants are to fully account for the use made of turnkey drilling monies contributed by the limited partners. This includes the use made of the turnkey drilling monies contributed when they were first received, and the leases, wells, equipment contributions, goods, and services which were eventually provided to fulfill the terms of the turnkey drilling contracts . . . [i]t is the determination of the Court that the Defendant must account for all of the transfers which were not pursuant to contemporaneous invoices to the partnership because otherwise the plaintiff will not be able to determine which transfers were in fact made for the benefit of the partnerships. The Defendants have the burden of explaining the transactions of the intercompany account which are not otherwise self evident in order to allow Plaintiff to understand what use was made of the

> partnership monies . . . In tracing the monies to the "ultimate recipient" it is the determination of the Court that the Defendants should trace the monies through all transfers among Defendants until the money is transferred to an unrelated entity . . . The Defendants may "tie in" the tax returns to the accounting as a whole, but the tax returns may not be used as principal source documents.

36. Defendants on March 2, 1988 made a second request for an extension of the Second Supplemental Accounting deadline. They agreed to comply with the document requests of Plaintiff's accountant if the filing deadline were extended.

37. The Court on March 14, 1988 entered its Order requiring Defendants to produce the documents as requested by Plaintiff's accountant and granting Defendants' request for extension of time to April 15, 1988.

38. The Defendants on April 15, 1988 filed their Second Supplemental Accounting and Plaintiff filed Notice of Objection and Second Renewed Motion for Sanctions and Entry of Default Judgment on August 5, 1988.

39. The Court's expert, Mr. Ostrander, on October 18, 1988 filed a report setting forth his opinion that the accounting did not substantially comply with the Orders of May 5, 1987, October 14, 1987, December 1, 1987 and February 4, 1988.

40. The Court again has been compelled to try this issue of compliance. The only issues of fact listed in the Court's February 23, 1989 Pre-hearing Order are:

1. Whether Defendants have materially complied with the Court's Orders of May 5, 1987, as amended and restated by Orders entered October 14, 1987, December 1, 1987 and February 4, 1988.

2. Whether the Defendants can show that all or any of the deficiencies cited in the reports of Jim T. Spears, C.P.A., Arthur Andersen and Co., and Charles Ostrander do not exist.

3. Whether any of the Defendants have intentionally or willfully refused or failed to provide the accounting required by the Court's order.

41. The Court as fact finder in addressing the technical aspects of accounting procedures must rely heavily on the testimony and reports of the independent Court-appointed expert.

42. Charles Ostrander, C.P.A., expert appointed by the Court testified generally in support of the accountants for Plaintiff. He testified:

(a) That the accounting prevented an immediate and full analysis of "where the money went";

(b) That tracing of funds could be accomplished but due to the co-mingling it would be difficult;

(c) That the Defendants did not follow the methodology previously set out in the

May 12, 1987 accounting by their failing to show the transactions in a chronological order;

(d) That he did not see evidence in the accounting that there was any attempt to actually trace monies to the ultimate recipients;

(e) That the listing of disbursements and receipts in the accounting after each program's funds had already been transferred out of the LOC was meaningless, i.e. by showing every alleged, "potential" person who could have been a recipient of the turnkey drilling funds, the Defendants further confuse the issue rather than eliminating it;

(f) That the accounting did not provide information as to the actual cost or evidence of actual cost of the leases contributed nor list of costs paid by the general partner for the leases nor a list of the value assigned to such leases;

(g) That there was no accounting for turnkey drilling costs for the 1976-1977-1978 programs and that the charges listed for the 1979 program were not reconciled in any manner to the general ledgers of the company;

(h) That because the Defendants failed to demonstrate the manner and method by which overhead charges were calculated, there was no way to determine whether the charges were proper in the accounting;

(i) That the Defendants failed to list which documents were not available for examination and they do not state which documents are necessary to perform a reconstruction for items such as the turnkey expenses; and

(j) Concluded he concurred with the reports and testimony of Plaintiff's accountants and that in his opinion the Defendants' Second Supplemental Accounting failed to comply with this Court's Orders.

43. The Court as fact finder in addressing the issue of willfulness must rely primarily upon the testimony of former counsel for the Defendants. Brad Keller, former counsel for Defendants, testified at the first compliance hearing that the Defendants understood the purpose of the accounting to be:

> . . . to demonstrate where the money went and why and how and when . . . how it had been spent . . . to show the tracing of funds either as they came into the various entities and flowed to some ultimate destination . . . the sources for the expenditures, where they went.

44. Defendants testified that they did not contact banks for records and that they could not represent that any one of the Defendants went to the banks to attempt to obtain missing bank documents.

45. Former counsel for Defendants, Frank Hagadorn and John Alden, stated in substance that the Defendant Galesi offered the accounting for the sole

purpose of obtaining a continuance of the trial and that he fully failed to comply with accounting orders thereafter entered by the Court. His failure brought about Hall Estill's withdrawal as counsel.

46. Mr. Alden, former counsel for Defendants, stated that Galesi had told him that he would never render an accounting to the Plaintiff.

47. The Defendants have failed to comply with the Orders of this Court in regard to the accounting. They have in the process of non-compliance spent many thousands of dollars to produce an insufficient accounting done upon their terms and not upon the terms agreed to in the original Order and specified in it and in the Court's subsequent Orders.

48. From the totality of the testimony, the action of Defendants is found to be willful.

CONCLUSIONS OF LAW

1. This Court has given Defendants three opportunities to comply with the Court's accounting Orders. Such failure constitutes bad faith refusal to comply with the Court's Order.

2. This Court has broad discretion in using its power to require adherence to its Court orders. *United States v. Riewe*, 676 F.2d 418 (10th Cir. 1982).

3. This Court must order a sanction appropriate to the severity of Defendants' abuse of the legal process.

4. Plaintiff is entitled to a judgment against the Defendants, jointly and severally, for his

investment of $1.9 million dollars [sic] less any portion of those funds which Defendants can establish were utilized for legitimate purposes under the terms and provisions of the Limited Partnership Agreements. There will be a trial at which the burden will be upon the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties.

5. Defendants still must comply with the accounting Orders of this Court and correct the deficiencies as found by the Court's expert. The supplemental accounting will be completed and filed on or before May 31, 1990.

6. Trial on the issue of Defendants' appropriate setoff will be held on August 20, 1990.

7. The issue of additional sanctions for fees, expenses and costs are reserved until completion of trial.

ORDERED this 8th day of February, 1990.

/s/ James O. Ellison
JAMES O. ELLISON
UNITED STATES
DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff, vs. DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; LAYTON OIL COMPANY, a Kansas Corporation, WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH, DELAWARE FLOOD COMPANY 1977 EH, DELAWARE FLOOD COMPANY 1978 FH, DELAWARE FLOOD COMPANY 1979 LTD., limited partnerships under the laws of Oklahoma; and MICHAEL GALESI, Defendants.	)	Case No. 83-C-179-E

ORDER

(Filed Jan. 29, 2002)

Now before the Court is the Post-Judgement Motion to: (1) Fix and Determine Pre-Judgment Interest Due on Judgment; (2) for an Immediate (Consent) Turnover Order with Respect to $57,785.39 of Escrowed Funds; (3) For the Entry of an Order Compelling the Turnover of the Balance of Funds Held in Escrow; (4) For the Entry of an Order

Reducing the March 30, 1989 Award Report and Recommendation of Magistrate Judge Jeffrey S. Wolfe to Judgment[1] and For the Entry of an Order Certifying this Court's June 7, 2001 Judgment for Registration Purposes (Docket No. 1071) of the Plaintiff Bernard Olcott and the Application to Alter or Amend Judgment (Docket No. 1073) of the Defendants Michael Galesi, William Douglas Layton, Layton Oil Company, a Delaware Corporation, 1976 D-H Program, 1977 E-H Program, 1978 F-H Program, 1979 Ltd. and Delaware Flood Company, an Oklahoma limited partnership (collectively "Defendants").

Pre-Judgment Interest

Plaintiff seeks "a threshold determination as to the manner and method of calculation of his pre-judgment interest entitlement." Defendants argue that plaintiff is not entitled to pre-judgment interest because the judgment is for sanctions, not damages, because previous judgments and the findings of fact and conclusions of law do not provide for pre-judgment interest, and because the damages were not "Certain and Definite." The Court finds that its Judgment of June 7, 2001 included an award of pre-judgment interest and finds no merit in the arguments of defendants to the contrary. Clearly the sanction awarded Plaintiff was a default judgment based on a theory of rescission. Pre-judgment interest is appropriate

[1] Plaintiff's fifth request, for the Entry of an Order Granting Plaintiff a 90 day extension of time within which to file and serve an application for an additional sanction award of counsel fees, accounting fees, costs, disbursement, expenses and a application for an award of taxed costs was GRANTED on June 25, 2001, Docket No. 1076.

on such a claim pursuant to statute, Okla. Stat. tit. 23, § 6, and caselaw. *See, e.g., U.S. Industries, Inc. v. Touche Ross & Co.*, 854 F.2d 1223 (10th Cir. 1998). In addition, damages awarded, which were the investment made by Plaintiff, less any portion of those funds which Defendants can establish were utilized for legitimate purposes under the Limited Partnership Agreements, were "capable of being made certain by calculation." The Court finds that the appropriate interest rate is, pursuant to Okla. Stat. tit. 15, § 266, six percent, and that the amount should be calculated from the stipulated dates and amounts of his investments. Such a calculation results in a net prejudgment interest amount of $1,679,144.55.

Funds held in Escrow

Defendants do not object to the entry of an order for payment of $57,785.39 to be paid to Plaintiff. Defendants do object to turning over the remainder of the funds, because ownership is disputed. Plaintiff acknowledges that ownership of the funds is disputed and requests that the funds remain invested in interest bearing accounts until ownership can be resolved. The Court finds that the funds should not be paid to Plaintiff at this time because of issues regarding ownership of the funds, but orders that they remain in an escrow account until these issues can be resolved.

The Attorneys' Fee Order of Magistrate Judge Wolfe

Plaintiff also requests that the March 30, 1989 Report and Recommendation of Magistrate Judge Wolfe awarding $60,765.00 in attorneys fees be reduced to judgment. Plaintiff points out that award was not previously reduced

to judgment because of the Court's conclusion of law in its February 8, 1990 Order which stated, "the issue of additional sanctions for fees, expenses and costs are reserved until completion of trial." Defendants ask that the court decline to reduce the Report and Recommendation to Judgment, arguing that the issue of attorneys fees should be considered all at once, and not "in a piecemeal fashion." Nonetheless, the Court sees no reason for delay with respect to this particular award which was litigated at length and made almost thirteen years ago.

Certification of Judgment for Registration Purposes

Plaintiff seeks certification of the Court's judgment for registration purposes, pursuant to 28 U.S.C. § 1963, which provides that a judgment may be certified at the conclusion of the appeal, when the appeal time has run, or at another time "for good cause shown." As "good cause," Plaintiff argues that a variety of sources reflect that Defendants have assets in property and other forms in New Jersey and New York, that Plaintiff has previously had problem collecting on Judgments against Mr. Galesi, and that there are a number of other Judgments against Mr. Galesi. The court finds that good cause has been shown for certification.

Motion to Alter or Amend

Defendants seek to alter or amend the Court's Judgment pursuant to Fed.R.Civ.P. 59(e), asserting that they should be credited for any damages pertaining to the 1977 program pursuant to the exercise of the "put." The Court finds however that the motion was filed out of time in that it was filed 12 business days after Judgment was entered.

Rule 59(e) requires such a motion to be filed within ten days. Defendants cite no authority for their assertion that the motion regarding pre-judgment interest prolongs the time in which defendants can file a 59(e) motion. Clearly, Defendants' motion is out of time and cannot be considered.

In conclusion, Plaintiff's post-judgment motion (docket #1071) is **Granted in part and Denied in part**. The Court finds that the amount of pre-judgment interest awarded in its judgment is $1,679,144.55; escrowed funds in the amount of $57,785.39 should be paid to Plaintiff immediately, with the remainder of the funds remaining in escrow; Plaintiff is entitled to an attorney fee award as outlined in the March 30, 1989 Report and Recommendation; and the Judgment should be certified for "good cause shown. Defendants' Application to Alter or Amend Judgment (docket #1073) is **Denied**.

IT IS SO ORDERED THIS 29th DAY OF JANUARY, 2002.

/s/ James O. Ellison
JAMES O. ELLISON,
SENIOR JUDGE
UNITED STATES
DISTRICT COURT

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff, v. DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; LAYTON OIL COMPANY, a Kansas corporation, WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH, DELAWARE FLOOD COMPANY 1977, EH, DELAWARE FLOOD COMPANY 1978 FH, DELAWARE FLOOD COMPANY 1979 LTD., limited partnerships under the laws of Oklahoma; and Michael Galesi, Defendants.	:	No. 83-C-179-E (Filed Aug. 27, 2003)

ORDER

Now before this Court is Affidavit of Thomas P. Bado, CPA Recalculating Pre-Judgment Interest Pursuant To New Jersey Rule 4:42-11(b) filed on July 17, 2003.

This Court entered judgment in favor of Plaintiff and against the Defendants in the principal amount of $1,077,014.70 plus pre-judgment interest on June 6, 2001.

By Order of January 29, 2001, this Court calculated its pre-judgment interest award to be in the amount of $1,679,144.55 pursuant to Oklahoma law.

The Defendants appealed this court's judgment to the Tenth Circuit Court of Appeals, which affirmed this Court's judgment in all respects, other than to remand for the limited purpose of recalculating this Court's pre-judgment interest award pursuant to New Jersey Law. *See, Olcott v. Delaware Flood Company et al,* 327 F.3d 115 at 1126 (10th Cir. 2003).

Upon remand, this Court by Order dated July 10, 2003, in part, directed the plaintiff to submit a proposed pre-judgment interest calculation pursuant to New Jersey Law. Defendants were directed to file any objection thereto within fifteen days.

On July 17, 2003, Plaintiff filed and served the Affidavit of Thomas P. Bado, CPA recalculating Pre-Judgment Interest Pursuant To New Jersey Rule 4:42-11(B) in the amount of $2,573,974.77 (doc. no. 1155). Defendants have not filed any Opposition thereto.

This Court having reviewed and considered the calculations set forth in said affidavit of Thomas P. Bado, CPA, and being satisfied in the premises;

IT IS THEREFORE, ORDERED and adjudged that this Court's order of January 29, 2002 be, and the same hereby is, amended in accordance with New Jersey Rule 4:42-11(b) to be in the amount of $2,573,974.77.

Done this 26th day of August, 2003.

/s/ James O. Ellison
JAMES O. ELLISON,
SENIOR JUDGE
UNITED STATES
DISTRICT COURT

ENTERED ON DOCKET

DATE 5-3-93

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff,	)	
vs.	)	No. 83-C-179-E
DELAWARE FLOOD COMPANY, et al., Defendants.	)	

ORDER AND JUDGMENT

(Filed Apr. 30, 1993)

Several motions pend herein:

1. The Motion of Arthur Anderson to file an amicus brief (docket #838);
2. Defendants' designation of Additional Parts of the Record (docket #840);
3. Plaintiff's Motion for Review of Order Settling Costs (docket #833);
4. The Motion of Defendants in Aid of Designation (docket #845);
5. The Application of Plaintiff for Relief from Order (docket #846);
6. The Renewed Motion of the Defendants for Post Judgment Relief (docket #849);
7. And the December 2, 1991 Application of Plaintiff to Reduce Sanctions to Judgment (docket #787).

The issues will be considered *ad seriatim*.

1. *Application of Arthur Andersen and Company to File an Amicus Curiae Brief* will be GRANTED. The brief concerns the issue of sanctions. Arthur Andersen has a special interest in the issue because of its accounting services rendered in this case.

2. *Defendants' Designation of Additional Parts of the record Pursuant to Fed.R.App.Proc. 10(B)(3)* is GRANTED. However, the related *Motion in Aid of Designation* which requests a hearing on the issue will be DENIED as unnecessary and moot.

3. *Plaintiff's Objection and Appeal of Order Settling Costs* and its related *Application and Brief for Relief from Ordered Settling Costs Entered by the Clerk on January 14, 1993* are DENIED. The Clerk of the Court correctly stated that the "expert witness fees and other fees" were previously granted as sanctions by the Court. The issue of sanctions is within the purview of the Court. It should not be entertained by the Clerk as a part of the Bill of Costs. The Order settling Costs entered by the Clerk on January 14, 1993 is, accordingly, AFFIRMED.

4. *The Renewed Motion of the Defendants for Post Judgment Relief* will be DENIED in its entirety. The motion may be reurged when the parties have complied with the directives and provisions of this Order.

5. *Plaintiff's Application to Reduce Sanctions to Judgment*. The remaining issue before the Court is whether and to what extent the Court has jurisdiction to enforce the terms of sanction orders previously rendered in this case. In reviewing the issue, the parties have invited the Court to consider the applicability of *Willy v. Coastal*

Corporation, ___ U.S. ___, 112 S.Ct. 1076, 117 L.Ed.2d 280 (1992) and *United States Catholic Conference v. Abortion Rights Mobilization, Inc.*, 487 U.S. 72, 108 S.Ct. 2268, 101 L.Ed.2d 69 (1988).

As a general proposition, the district court is divested of jurisdiction over a case which has been appealed. However, the district court retains jurisdiction over collateral matters not involved in the issue on appeal. *Garcia v. Burlington Northern Railroad Company*, 818 F.2d 713, 721 (10th Cir. 1987). Thus, as a threshold matter, the Court must determine whether the sanction issue is collateral to the issue raised by Plaintiff in his appeal. On November 13, 1992, this Court entered an Order dismissing this case, finding that Plaintiff's claims were time-barred; therefore the Court was deprived of subject-matter jurisdiction. It is that Order which Plaintiff challenges on appeal. Clearly, the sanctions issue is collateral to the Statute of Limitations or Repose issue. Accordingly, the Court finds consideration of Plaintiff's Motion to Reduce Sanctions to Judgment is not precluded by the appeal.

Will the lack of subject-matter jurisdiction then work to deprive the Court of authority to consider the sanction issue. The answer is ubiquitous in the law: "it depends". *Catholic Conference* teaches us that an order of civil contempt against a non-party for refusal to comply with a discovery order is not enforceable where the district court lacked subject-matter jurisdiction and the party's disobedience does not relate to a discovery order issued in aid of determining the jurisdiction issue. *Id.*, 108 S.Ct. at 2270-2272. In *Catholic Conference*, abortion rights groups (collectively "ARM") sought revocation of the tax-exempt status of the Roman Catholic Church in the United States,

claiming that the position espoused by the United States Catholic Conference and the National Conference of Catholic Bishops on the abortion issue amounted to participation in political activities in violation of the anti-electioneering provision of 26 U.S.C. §501(c)(3). The two Conferences were dismissed as parties to the suit but were subsequently served subpoenas for document production during discovery. The Court issued a discovery order; the Conferences refused to comply; the Court found the Conferences in civil contempt and assessed fines. The Supreme court found that a federal Court's subpoena power, pursuant to Rule 45 of the Federal Rules of Civil Procedure, is curtailed by the limited jurisdiction granted federal courts under Article III of the Constitution. Thus,

> "if a district court does not have subject-matter jurisdiction over the underlying action, and the process was not issued in aid of determining that jurisdiction, then the process is void and an order of civil contempt based on refusal to honor it must be revered."

Id., 108 S.Ct. at 2270.

Subsequently, in 1992, the Supreme Court revisited the arena and opined that

> while "lack of subject-matter jurisdiction of a case in a federal court . . . precludes further adjudication of it . . . such a determination does not automatically wipe out all proceedings had in the district court at a time when the district court operated under the misapprehension that it had jurisdiction.

Willy, 112 S.Ct. at 1080. In *Willy*, Petitioner sought redress against his former employer for his discharge from

his position as "in house" counsel, claiming he was impermissibly terminated as a "whistle blower". The district court dismissed the case under Rule 12(b)(6), Fed.R.Civ.P., and imposed sanctions against Petitioner and his attorney under Rule 11, Fed.R.Civ.P. The sanctionable conduct included filings which "'create[d] a blur of absolute confusion.'" *Id.* at 112 S.Ct. 1078 (quoting App. to Pet. for Cert. A-7) including "a 1,200 page, unindexed, unnumbered pile of materials that the district court determined 'to be a conscious and wanton affront to the judicial process . . .'" *Id.* The district court's order was appealed twice and affirmed both times. On the second appeal, the Fifth Circuit, relying upon Supreme Court precedent, based its affirmance upon the "inherent powers" of the federal courts and included Rule 11 sanctions as one of those powers "necessary to the exercise of all others".[1] *Willy v. Coastal Corp.*, 915 F.2d 965 (5th Cir. 1990). The Fifth Circuit cited the seminal case on Rule 11 sanctions, *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 110 S.Ct. 2447, 110 L.Ed.2d 359 (1990) and quoted its conclusion:

> "Like the imposition of costs, attorney's fees, and contempt sanctions, the imposition of a Rule 11 sanction is not a judgment on the merits of an action. Rather, it requires the determination of a collateral issue: whether the attorney has abused the judicial process, and if so, what sanction would be appropriate."

---

[1] On appeal, the Supreme Court did not reach the issue of whether the circuit's rationale was appropriate because it affirmed the decision on other grounds, *infra*.

Id., 915 F.2d at 967 (*quoting Cooter*, *supra*, 110 S.Ct. at 2456).

In the instant case, the Court must consider the continued viability of the Court's Order of October 14, 1987, the Findings and Recommendations of the United States Magistrate filed July 28, 1988 and the Report and Recommendation of the Magistrate filed August 29, 1988.[2] In its October 14th Order the Court considered the Plaintiff's Renewed Motion for Sanctions for Noncompliance with Discovery Orders. The Court had previously ordered the Defendant "to furnish a complete and meaningful formal accounting of the financial affairs" of the limited partnership defendants. *See*, October 14th Order at 1. Following many misadventures (the recital of which need not detain us here, but are set out briefly below), the Court appointed an expert to determine the sufficiency of that accounting which was eventually forthcoming. The Court received that report and also heard extensive testimony and other evidence at a hearing held May 12, 1987. The evidence pointed ineluctably to the conclusion that the accounting was sorely lacking in the data, documentation, accuracy and explanation required of a credible accounting. The Court, pursuant to Rules 16 and 37(b), Fed.R.Civ.P., entered the following as sanctions against the Defendants:

1. To pay all fees and expenses of Plaintiff's counsel and Plaintiff's accounts incurred for services rendered in connection with resolving the sufficiency

[2] The Court has determined that all orders prior to October 14, 1987, which touch on the accounting issue were not sanction orders and are, therefore, not under consideration herein.

of the accounting (Plaintiff to file appropriate fee applications);

2. To pay the statement of the Court's expert, Charles Ostrander, in the sum of $14,275.00 by October 21, 1987.

The matter was referred to the Magistrate to hear the evidence on the appropriate amount of sanctions to be imposed pursuant to the October 14th Order. The Magistrate recommended (at docket #471) as follows.

1. Arthur Andersen fees and expenses: $171,789.20;

2. Jim Spears' fees and expenses: $19,511.58;

3. Counsel Feinsilver's fees: $106,755; counsel Pennisi's fees: $55,440; counsel Gibson's fees: $10,250 for a total Plaintiff's attorneys fees of $166,445 and related expenses of $28,891.30.

The total amount of the sanction award (exclusive of the Ostrander fee) was computed to be $386,637.98. Subsequently, the Plaintiff supplemented his application. The Magistrate found, at docket #497, his sanction award should be supplemented by the amount of $1,615 for attorney's fees and expenses incurred after October 14, 1987 for services rendered in challenging the sufficiency of the accounting. The first question for consideration is whether the Order and the Magistrate's two recommendations more closely resemble a *Willy* sanction award or a *Catholic Conference* civil contempt award. The Supreme Court has obligingly initiated the analysis for us. In distinguishing *Catholic Conference* from *Willy*, Chief Justice Rehnquist, speaking for a unanimous court, emphasized that *Catholic Conference* did *not* establish "the proposition that a sanction must fall if imposed when jurisdiction is in fact absent. The difference in the cases

lies in the fact that *Catholic Conference* sought to compel the future behavior of a party, while the sanction in *Willy* was in its nature *punitive*, to chastise a party for non-compliance with the judicial process.

> A civil contempt order has much different purposes than a Rule 11 sanction. Civil contempt is designed to force the contemnor to comply with an order of the court . . . , Rule 11 is designed to punish a party who has already violated the court's rules . . . given that civil contempt is designed to coerce compliance with the court's decree, it is logical that the order itself should fall with a showing that the court was without authority to enter the decree . . . The interest in having rules of procedure obeyed, by contrast, does not disappear upon a subsequent determination that the court was without subject-matter jurisdiction.

Id. 112 S.Ct. at 1081 (*citations omitted*).

In the case at bar, this Court relied upon the authority conferred by Rules 16 and 37, Fed.R.Civ.P. in its October 14th order. Is the order in the nature of a sanction or of civil contempt? A review of the Order in light of the record reveals that it is both: it sought both to sanction the past behavior of the Defendants in impeding the judicial process and to impel them to mend their ways in the future. Turning first to the text of the applicable rules Rule 16(f) entitled "Sanctions" states in relevant part:

> If a party or party's attorney fails to obey a . . . pre-trial order, or fails to participate in good faith, the judge, upon motion or the judge's own initiative, may make such orders with regard thereto as are just, and among others any of the orders provided in Rule 37(b)(2)(B), (C) (D). In

> lieu of or in addition to any other sanction, the judge shall require the party or the attorney representing the party or both to pay the reasonable expenses incurred because of any noncompliance with this rule, including attorney's fees . . .

Rule 37 entitled "Failure to Make or Cooperate in Discovery: Sanctions" provides, in part, at (b):

> In lieu of any of the foregoing orders or in addition thereto, the court shall require the party failing to obey the order or the attorney advising that party or both to pay the reasonable expenses, including attorney's fees, caused by the failure . . .

Turning next to the Court's factual findings which underpin its October 14th order, the following bears repeating: that the sanction order was precipitated by a pattern of recalcitrance by Defendants, which the Court attempted to punish *and* forestall. A fair reading of the October 14th Order compels the conclusion that the Order was a hybrid of civil contempt and of sanctions. The Court first ordered a full and complete accounting on March 11, 1986 to be filed by September 4, 1986. That accounting was not filed until January of 1987, some three months after the date set by the Court. That accounting was blatantly inadequate; the Court then ordered on March 17, 1987, an amended and corrected accounting to be filed by May 11, 1987 (trial was set at that time on the June 15, 1987, docket). The amended accounting was filed May 12th. The Plaintiff challenged the adequacy of the amended accounting. The Court enlisted the services of an expert to analyze the accounting and determine its sufficiency in light of the Court's Orders. The Court also received evidence and argument on the issue and then rendered its decision on

October 14, 1987 that sanctions were appropriate. The Court also directed the Defendants to comply with its accounting orders and it warned Defendants that future recalcitrance would be deemed bad faith and would justify entry of procedural default. The Court then referred the matter to the Magistrate to determine the amount of fees and expenses generated by Plaintiff's counsel and accountants in challenging the sufficiency of Defendant's accounting.

On this record, it seems beyond peradventure that the October 14th Order was, in part, analogous to a Rule 11 sanction for frustrating and impeding the judicial process.[3] And this Court specifically so finds. The Court, therefore, concludes that, in spite of the fact that the Order had a civil contempt component, it was nonetheless an authorized exercise of its powers pursuant to *Willy*. The order is, thus, enforceable. The Magistrate's recommendations (filed July 28, 1988 and August 29, 1988, respectively), the Court finds to be reasonable and appropriate. Those

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[3] The Court also concludes as a matter of law that the sanctions imposed herein are an authorized exercise of its inherent powers. The Court notes that in *Willy*, 915 F.2d at 966, the Fifth Circuit held that the District Court's Rule 11 sanction order was an exercise of its inherent powers, which is to say, those powers "'necessary to the exercise of all others.'" *Id.*, *citing*, *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 764, 100 S.Ct. 2455, 2463, 65 L.Ed.2d 488 (1980), citing *United States v. Hudson*, 7 Cranch 32, 34, 3 L.Ed. 259 (1812). By logical extension this Court now holds that, under the facts of this case, Rules 16 and 37, Fed.R.Civ.P., are an authorized exercise of its inherent powers "necessary to the exercise of all others." It should also be noted that the Supreme Court in *Willy* did not reach the inherent powers issue because it found the "sanction may constitutionally be applied even when subject-matter jurisdiction is eventually found lacking . . . " *Id.*, 112 S.Ct. at 1081, n. 5.

recommendations are now affirmed and adopted by the Court. The Plaintiff's Motion to Reduce Sanctions to Judgment is granted as to the October 14, 1987, Order; the Findings and Recommendations of the Magistrate filed July 28, 1988 and the Report and Recommendation of the Magistrate filed August 29, 1988.

ORDERED this 30th day of April, 1993.

/s/ James O. Ellison
JAMES O. ELLISON,
Chief Judge
UNITED STATES
DISTRICT COURT

Bernard OLCOTT, Plaintiff-Appellant,

v.

DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; Lawton Oil Company, a Kansas corporation; William Douglas Layton, individually and as general partner of Delaware Flood Company, 1976 DH; Delaware Flood Company, 1977, EH; Delaware Flood Company, 1978, FH; Delaware Flood Company, 1979, Ltd., limited partnerships under the laws of Oklahoma; Michael Galesi, Defendants-Appellees.

Bernard OLCOTT, Plaintiff-Appellee,

v.

DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; Delaware Flood Company, 1976 DH; Delaware Flood Company, 1977, EH; Delaware Flood Company, 1978, FH; Delaware Flood Company, 1979, Ltd., limited partnerships under the laws of Oklahoma; Michael Galesi, Defendants-Appellants,

and

Layton Oil Company, a Kansas corporation; William Douglas Layton, individually and as General Partner of Delaware Flood Company, 1976, DH, Defendants.

Bernard OLCOTT, Plaintiff,

v.

DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; Delaware Flood Company, 1977, EH; Delaware Flood Company, 1978, FH; Delaware Flood Company, 1979, Ltd., limited partnerships under the laws of Oklahoma; Michael Galesi, Defendants,

and

Layton Oil Company, a Kansas corporation; William Douglas Layton, individually and as General Partner of Delaware Flood Company, 1976, DH, Defendants-Appellants.

Bernard OLCOTT, Plaintiff-Appellee,

v.

DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; Delaware Flood Company, 1976 DH; Delaware Flood Company, 1977, EH; Delaware Flood Company, 1978, FH; Delaware Flood Company, 1979, Ltd., Michael Galesi, Defendants-Appellants,

and

Layton Oil Company, a Kansas corporation; William Douglas Layton, individually and as General Partner, Defendants.

Nos. 92-5242, 93-5147, 93-5148 and 94-5005.

United States Court of Appeals
Tenth Circuit

Feb. 26, 1996.

Appeal from the United States District Court for the Northern District of Oklahoma; D.C. No. 83-C-179-E.

David Feinsilver, Feinsilver & Weiner, Millburn, New Jersey, for Appellant Bernard Olcott.

William C. Kellough (Reuben Davis with him on the briefs), Boone, Smith, Davis, Hurst & Dickman, Tulsa, Oklahoma, for Defendants/Appellees and Cross-Appellants.

Before SEYMOUR, Chief Judge; and PORFILIO and EBEL, Circuit Judges.

JOHN C. PORFILIO, Circuit Judge.

Today, we are called upon to resolve a fourteen year-old federal securities dispute raising choice of law and sanctions issues. Bernard Olcott brought this Rule 10b-5 securities action alleging he was defrauded regarding his 1976-1979 investments in four limited partnerships. After a lengthy pretrial and discovery process, the district court concluded the limitations period had run on Mr. Olcott's federal claims and dismissed his action in its entirety, including his pendent state claims. Mr. Olcott appeals these dismissals in No. 92-5242.

During the pretrial process, the district court sanctioned the defendants for their failure to comply with a series of court orders concerning an accounting of the financial affairs of the four limited partnerships. All the defendants challenge the propriety of the district court's sanctions in their cross-appeals.[1] Delaware Flood Company and Michael Galesi appeal the sanctions in No. 93-5147, and Layton Oil Company and William Douglas Layton appeal in No. 93-5148.[2]

Finally, in No. 94-5005, the defendants appeal the district court's disposition of two remaining issues: the court's refusal to release funds held in escrow gained from the sale of some of the limited partnerships' assets; and, the court's retention of the defendant's security bond to guarantee the payment of the court's sanctions order.

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[1] Throughout this opinion, we refer to all the corporate and individual defendants collectively as "the defendants." When we refer to any of the defendants individually, we do so by name.

[2] In their brief, Layton Oil Company and William Douglas Layton adopt the arguments made by Delaware Flood Company and Michael Galesi.

Our holdings in this case may be summarized as follows. We conclude the district court properly dismissed Mr. Olcott's federal claims based on his 1976, 1977, and 1978 investments as time barred by the Third Circuit's three-year statute of repose. However, we remand to the district court for a factual finding when Mr. Olcott possessed inquiry notice of the underlying facts relating to his 1979 investment. On remand, the district court must determine if Mr. Olcott brought this claim within the one year statute of limitation. We also remand the district court's dismissal of Mr. Olcott's pendent state claims for it to conduct the appropriate death knell analysis. We affirm the district court's imposition of a sanction of $402,527.98 against the defendants for their violations of Fed.R.Civ.P. 16(f) and 37(b)(2). We decline to consider the district court's $1.9 million default judgment because the district court did not treat it as a final determination. We remand the issue of whether to release the $213,143 in proceeds from the sale of limited partnership assets from court supervision to the district court for further factual findings. Finally, we reverse the district court and exonerate the defendants' $50,000 bond.

I.

The interminable saga we have before us began when Mr. Olcott invested a total of $1.9 million in four oil drilling and exploration limited partnerships in 1976, 1977, 1978, and 1979. Not pleased with the results of his investment, Mr. Olcott filed suit, alleging the limited partnerships were operated fraudulently. Mr. Olcott named as defendants all four limited partnerships, Delaware Flood Company 1976 DH, Delaware Flood Company

1977 EH, Delaware Flood Company 1978 FH, and Delaware Flood Company 1979 LTD; and Layton Oil Company, Delaware Flood Company, Michael Galesi and William Douglas Layton. These additional defendants had various relationships with the four limited partnerships and each other. Delaware Flood Company was the general partner of all four limited partnerships. In turn, when Mr. Olcott filed suit, Layton Oil Company and William Douglas Layton were the general partners of Delaware Flood Company which was itself a limited partnership. Layton Oil Company subsequently went out of business in 1983.

Michael Galesi was intertwined with the affairs of the other parties in several ways. He was a promoter of the four limited partnerships and a limited partner in some of them. Mr. Galesi also originally was a limited partner of Delaware Flood Company and currently is its general partner. Finally, Mr. Galesi owns Equinox Oil Company which purchased Layton Oil Company's assets, and succeeded to the general partnership interest the defunct company had in the four limited partnerships.

The procedural history of this case has reached Byzantine proportions. Initially, on July 7, 1982, Mr. Olcott filed suit in federal court in the District of New Jersey. On February 18, 1983, the court granted the defendants' forum non conveniens motion made pursuant to 28 U.S.C. § 1404, transferring the case to the Northern District of Oklahoma. A lengthy, multi-round pretrial dispute over an accounting of the financial affairs of all the players ensued. We describe this accounting imbroglio in detail in conjunction with our substantive discussion of the issue in Part IV.

While this case was pending, the Supreme Court decided *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 111 S.Ct. 2773, 115 L.Ed.2d 321 (1991). In *Lampf,* the Court held an implied Rule 10b-5, 15 U.S.C. § 78j(b), claim must be filed no more than three years after the underlying events and within one year after the fraud is discovered. *Id.* at 364, 111 S.Ct. at 2782. In so holding, the Court borrowed the statute of limitations period for express actions as provided under the 1933 and 1934 Securities Acts. *Id.* at 362, 111 S.Ct. at 2781. The same term the Court announced new rules developed in civil cases must be applied retroactively to all pending similar cases. *James B. Beam Distilling Co. v. Georgia,* 501 U.S. 529, 111 S.Ct. 2439, 115 L.Ed.2d 481 (1991) (plurality opinion). In response to *Lampf* and *Beam,* the defendants filed a motion to dismiss which the district court granted on September 25, 1991. Mr. Olcott appealed to this court.

While Mr. Olcott's appeal was pending, Congress amended the Securities Act to prevent the retroactive application of *Lampf.* The amendment provided the applicable statute of limitations period for pre-*Lampf* Rule 10b-5 implied actions would be that of the jurisdiction where the federal court was located, 15 U.S.C. § 78aa-1, the position explicitly rejected in *Lampf.*[3] Mr. Olcott

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[3] The amended statute provides:

15 U.S.C. § 78aa-1. Special provision relating to statute of limitations on private causes of action

(a) Effect on pending causes of action

The limitation period for any private civil action implied under section 78j(b) of this title that was commenced on or before June 19,

(Continued on following page)

petitioned this court to reinstate his cause of action pursuant to section 78aa-1. We granted his motion in an unpublished order of June 5, 1992, and remanded the case to the district court.

1991, shall be the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991.

(b) Effect on dismissed causes of action

Any private civil action implied under section 78j(b) of this title that was commenced on or before June 19, 1991 –

(1) which was dismissed as time barred subsequent to June 19, 1991, and

(2) which would have been timely filed under the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991,

shall be reinstated on motion by the plaintiff not later than 60 days after Dec. 19, 1991.

During the pendency of this appeal, the Supreme Court declared at least part of this amendment unconstitutional on separation of powers grounds. The Court reasoned the amendment unconstitutionally required the federal courts to reopen final judgments. *Plaut v. Spendthrift Farm, Inc.*, ___ U.S. ___, ___, 115 S.Ct. 1447, 1463, 131 L.Ed.2d 328 (1995). After the Court decided *Plaut,* we ordered the parties in this appeal to file supplemental briefs on the applicability of the new decision. We conclude *Plaut* has no applicability here because the instant case was pending within the meaning of section 78aa-1(a). The Court's decision in *Plaut,* and the structural separation of powers concerns which animate it, apply only to subsection (b) of the amendment. In short, we believe nothing in *Plaut* disturbs our prior conclusion subsection (a) is constitutional. *Anixter v. Home-Stake Prod. Co.*, 977 F.2d 1533, 1543-47 (10th Cir.1992) (*Anixter II*), *cert. denied,* 507 U.S. 1029, 113 S.Ct. 1841, 123 L.Ed.2d 467 (1993). *See also Freeman v. Laventhol & Horwath,* 34 F.3d 333, 342-43 and n. 3 (6th Cir.1994) (noting the distinction between subsections (a) and (b) in holding subsection (a) was constitutional).

On remand, the defendants renewed their motion to dismiss which the district court granted. The court explained its reasoning in two orders dated September 23, 1991, and November 12, 1992. First, the court concluded the law of the transferor court applied. Because the case was originally filed in New Jersey, the court applied Third Circuit law. Second, the district court found the Third Circuit's limitations period required a cause of action to be filed within three years of the underlying events and one year from the time the plaintiff had inquiry notice of the fraud. *In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537 (3d Cir.1988) (en banc), *cert. denied*, 488 U.S. 849, 109 S.Ct. 131, 102 L.Ed.2d 103 (1988). Third, the district court concluded this rule should be applied retroactively. Fourth, the court held Mr. Olcott's claims based on his 1976, 1977, and 1978 investments were time barred because he brought his lawsuit more than three years after the underlying events. Fifth, the court ruled Mr. Olcott's claim based on his 1979 investment was also time barred because Mr. Olcott filed suit in excess of one year after he had notice of the alleged fraudulent activities.

In addition, at the same time the parties litigated the limitations period issue, an ongoing discovery dispute concerning the defendants' repeated failure to provide a complete accounting of the financial affairs of the interlocking partnerships occurred. Ultimately, the defendants' continued recalcitrance in providing the accounting led the district court to sanction them in the sum of $402,527.98 for Mr. Olcott's attorney's fees and accounting expert expenses, and the fee for the court's expert accountant.

Further, the district court ordered the proceeds from the sale of oil and natural gas assets of the four limited partnerships to be held in escrow pending the conclusion

of this litigation. On February 22, 1990, the court approved the sale of limited partnership assets to Delaware Flood Company, the highest bidder in an open, advertised auction, for $237,143. The court denied the defendants' requests to release these funds.

Finally, the district court required the defendants to post two bonds. First, the defendants were required to post a bond for $50,000 after the court's original March 17, 1987 sanctions order. Second, the court required the defendants to post a supersedeas bond in the amount of $402,527.98 after the court's final April 30, 1993 sanctions order.[4]

II.

Mr. Olcott argues the district court improperly dismissed his Rule 10b-5 claims on limitations period grounds. We review the district court's decision on jurisdictional questions de novo. *Laguna Gatuna, Inc. v. Browner,* 58 F.3d 564, 565 (10th Cir.1995), *cert. denied,* ___ U.S. ___, 116 S.Ct. 771, 133 L.Ed.2d 724 (1996); *FDIC v. Hulsey,* 22 F.3d 1472, 1479 (10th Cir.1994). We also review choice of law determinations de novo. *Rocky Mountain Helicopters, Inc., v. Bell Helicopter Textron, Inc.,* 24 F.3d 125, 128 (10th Cir.1994); *Shearson Lehman Bros., Inc., v. M & L Investments,* 10 F.3d 1510, 1514 (10th Cir.1993). The district court's findings of jurisdictional facts are

[4] In their brief, the defendants argue the supersedeas bond was in the amount of $400,913. Our calculation of the amount of the sanction matches the docket sheet's slightly greater figure.

reviewed for clear error. *Holt v. United States,* 46 F.3d 1000, 1003 (10th Cir.1995).

A.

To begin with, we must determine the proper limitations period. Mr. Olcott's lawsuit was reinstated pursuant to 15 U.S.C. § 78aa-1. Because his appeal was pending before this court when the statute was amended, subsection (a) applies.

> **(a) Effect on pending causes of action**
>
> The limitations period for any private cause of action implied under section 78j(b) of this title that was commenced on or before June 19, 1991, shall be the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991.

In the ordinary case, the statute calls for applying the law as it existed on June 19, 1991, in the jurisdiction where the dispute was pending. However, cases like this which have been transferred between jurisdictions with different limitations periods present a thorny choice of law problem.

The parties dispute whether to apply the limitations period of the transferor jurisdiction, the Third Circuit, or the transferee jurisdiction, the Tenth Circuit. The defendants argue the Third Circuit rule should apply, while Mr. Olcott urges the adoption of the Tenth Circuit standard instead.[5]

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[5] The choice of law makes a significant difference to Mr. Olcott. In the Third Circuit, a Rule 10b-5 complaint must be filed within "one year

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The district court concluded Third Circuit law governed after applying two Supreme Court decisions which held, in diversity cases, the transferor forum law applies after transfers made pursuant to 28 U.S.C. § 1404(a). *Ferens v. John Deere Co.,* 494 U.S. 516, 110 S.Ct. 1274, 108 L.Ed.2d 443 (1990); *Van Dusen v. Barrack,* 376 U.S. 612, 84 S.Ct. 805, 11 L.Ed.2d 945 (1964). We agree.

In *Van Dusen,* the Court held, "where the defendants seek transfer, the transferee district court must be obligated to apply the state law that would have been applied if there had been no change of venue." *Van Dusen,* 376 U.S. at 639, 84 S.Ct. at 821. The Court concluded, "[a] change of venue under § 1404(a) generally should be, with respect to state law, but a change of courtrooms." *Id.* In so doing, the Court explicitly left unaddressed the question of whether the identical rule would apply if a plaintiff, rather than a defendant, initiated the transfer. *Id.* at 640, 84 S.Ct. at 821. In *Ferens,* the Court answered this remaining question in the affirmative, holding "that the transferor

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after the plaintiff discovers the facts constituting the violation, and in no event more than three years after such violation." *In re Data Access Sys. Sec. Litig.,* 843 F.2d 1537, 1550 (3d Cir.) (en banc), *cert. denied,* 488 U.S. 849, 109 S.Ct. 131, 102 L.Ed.2d 103 (1988). In contrast, in the Tenth Circuit, pre-*Lampf* Rule 10b-5 suits were "subject to the appropriate limitations statute of the state in which the alleged violation occurred." *Hackbart v. Holmes,* 675 F.2d 1114, 1120 (10th Cir.1982). *See also Anixter v. Home-Stake Prod. Co.,* 939 F.2d 1420, 1441 (10th Cir.1991) (*Anixter I*), *cert. granted and judgment vacated by Dennler v. Trippet,* 503 U.S. 978, 112 S.Ct. 1658, 118 L.Ed.2d 382 (1992). In this case, Oklahoma's two-year statute of limitations which runs from the actual or constructive discovery of the fraud and includes principles of equitable tolling would apply. Okla.Stat. tit. 12, § 95(3) (West 1995); *Anixter II,* 977 F.2d at 1544 n. 3.

law should apply regardless of who makes the § 1404(a) motion." *Ferens,* 494 U.S. at 531, 110 S.Ct. at 1284.

In the instant case, the defendants requested the transfer pursuant to § 1404(a) so the original *Van Dusen* rule seemingly would apply. However, both *Van Dusen* and *Ferens* were diversity cases. Underlying both decisions was the Court's long-standing federalism concern of maintaining the integrity of our dual federal and state systems. *See, e.g., Van Dusen,* 376 U.S. at 638, 84 S.Ct. at 820 ("Applying [*Erie's*] analysis to § 1404(a), we should ensure that the 'accident' of federal diversity jurisdiction does not enable a party to utilize a transfer to achieve a result in federal court which could not have been achieved in the courts of the State where the action was filed."); *Ferens,* 494 U.S. at 524, 110 S.Ct. at 1280 ("The policy that § 1404(a) should not deprive parties of state-law advantages, although perhaps discernible in the legislative history, has its real foundation in *Erie*. . . . ").

This action was grounded in Rule 10b-5 making it a federal question, not a diversity case. Therefore the question becomes: should the rule the transferor forum law applies be extended to this federal question case?

While this question represents an issue of first impression for this court, we are not wholly without guidance. The Second and Seventh Circuits have previously entered the thicket with divergent results.[6] In *Menowitz v.*

[6] Of the remaining circuits, only the Eighth Circuit has also touched on this issue by noting the circuit split. *See Kansas Pub. Employees Retirement v. Reimer & Koger Assoc., Inc.,* 61 F.3d 608, 611 n. 4 (8th Cir.1995) ("There is some divergence of authority concerning whether the transferor district's choice of law can ever follow the case if

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Brown, 991 F.2d 36 (2d Cir.1993) (per curiam), the Second Circuit considered whether *Van Dusen* should apply in a Rule 10b-5 case which had been consolidated for pretrial purposes pursuant to 28 U.S.C. § 1407(a). The court concluded *Van Dusen* was inapplicable, and the law of the transferee court should apply. The court reasoned, "the choice of a limitations period for a federal cause of action is itself a question of federal law." *Id.* at 41 (quoting *DelCostello v. International Bhd. of Teamsters,* 462 U.S. 151, 159 n. 13, 103 S.Ct. 2281, 2288 n. 13, 76 L.Ed.2d 476 (1983) (citations omitted)). After concluding *Van Dusen* "rests upon *Erie,*" *id.* at 40, the court determined its reach was limited to diversity cases. The court explained:

> Although federal courts sometimes arrive at different constructions of federal law, federal law (unlike state law) is supposed to be unitary. Thus, the rule of *Van Dusen* does not apply by analogy where a case is transferred under § 1407 to a federal court that has a different construction of relevant federal law than the federal court in which the action was filed. . . . Applying *Van Dusen* by analogy to issues of federal law also runs contrary to the principle that, until the Supreme

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the underlying cause of action arises under federal rather than state law."), *cert. denied,* ___ U.S. ___, 116 S.Ct. 915, 133 L.Ed.2d 845 (1995). In addition, several commentators have addressed the issue of whether the *Ferens* and *Van Dusen* rule should apply to federal question cases. *See generally* Kimberly Jade Norwood, *Double Forum Shopping and the Extension of Ferens to Federal Claims That Borrow State Limitation Periods,* 44 Emory L.J. 501 (1995); Robert A. Ragazzo, *Transfer and Choice of Law: The Appellate Model,* 93 Mich.L.Rev. 703 (1995); Tom M. Fini, *The Scope of the Van Dusen Rule in Federal-Question Transfers,* 1992/1993 Ann.Surv.Am.L. 49; Richard L. Marcus, *Conflicts Among Circuits and Transfers Within the Federal System,* 93 Yale L.J. 677 (1984).

> Court speaks, the federal circuit courts are under duties to arrive at their own determinations of the merits of federal questions presented to them. . . .

Menowitz, 991 F.2d at 40.

In contrast, the Seventh Circuit reached the opposite conclusion in *Eckstein v. Balcor Film Investors,* 8 F.3d 1121 (7th Cir.1993), *cert. denied,* ___ U.S. ___, 114 S.Ct. 883, 127 L.Ed.2d 78 (1994). There, the court was faced with a case which was originally transferred for pretrial purposes under § 1407(a), but later permanently transferred pursuant to § 1404(a). *Id.* at 1124. The court acknowledged the general rule which concerned the Second Circuit in *Menowitz.*

> Are different circuits like different states for the purposes of *Van Dusen* and *Ferens?* Usually not. *In re Korean Air Lines Disaster,* 829 F.2d 1171 (D.C.Cir. 1987) (Ruth B. Ginsburg, J.), affirmed on other grounds under the name *Chan v. Korean Air Lines, Ltd.,* 490 U.S. 122, 109 S.Ct. 1676, 104 L.Ed.2d 113 (1989). A single federal law implies a national interpretation. Although courts of appeals cannot achieve this on their own, the norm is that each court of appeals considers the question independently and reaches its own decision, without regard to the geographic location of the events giving rise to the litigation.

Eckstein, 8 F.3d at 1126. However, the court reasoned it must determine the applicability of this general rule against the backdrop of Congress' intent in enacting the statutory amendment in response to *Lampf.* The court continued:

> We agree with *Korean Air Lines* that a transferee court normally should use its own best judgment

> about the meaning of federal law when evaluating a federal claim, but § 27A instructs us to act differently.[7] Section 27A recognizes that different circuits had taken different approaches to the appropriate statute of limitations in suits under § 10(b), and it codifies this fractured nature of federal law for cases filed before June 20, 1991. Congress requires us to apply federal law as courts understood it at a point in the past rather than to make an independent judgment about what that law actually is.

Eckstein, 8 F.3d at 1126. Finally, the *Eckstein* court distinguished the earlier Second Circuit case:

> *Menowitz* held that *Van Dusen* and *Ferens* apply only in diversity cases. We believe that this conclusion disregards both the language of § 27A (whose reference to "the jurisdiction" implies a *non*-uniform federal law) and the holdings of *Van Dusen* and *Ferens,* which construed § 1404(a) rather than any principle of state law. Although both of those cases arose under the diversity jurisdiction, their references to *Erie R.R. v. Tompkins,* 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938), do not imply a ruling limited to state law. *Erie* is itself part of national law, interpreting the Rules of Decision Act, 28 U.S.C. § 1652. *Van Dusen* and *Ferens* accordingly apply whenever different federal courts properly use different rules. . . . When the law of the United States is geographically non-uniform, a transferee court should use the rule of the transferor forum in order to implement the central conclusion of *Van Dusen* and

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[7] Section 27A refers to the Securities Act of 1934 which Congress amended in response to *Lampf.* This section has been codified at 15 U.S.C. § 78aa-1. We refer to this provision by its code section throughout this opinion.

> *Ferens:* that a transfer under § 1404(a) accomplishes "but a change of courtrooms". *Van Dusen,* 376 U.S. at 639, 84 S.Ct. at 821. Section 27A presents such a situation.

Id. at 1127 (parallel citations omitted).

We agree with the Seventh Circuit's holding and analysis in *Eckstein.* We believe the clear import of Congress' enactment of § 78aa-1 was to eliminate the retroactive application of *Lampf.* Congress sought to reinstate the pre-*Lampf* circuit disharmony. In short, unlike the typical situation, Congress specifically intended that "the geographical location of the events giving rise to the litigation," *id.* at 1126, should explicitly be taken into consideration. We also agree with the Seventh Circuit that it therefore makes no sense for the applicable law to change simply as a result of a motion to transfer. Further, the legislative history of § 78aa-1 "certainly does not justify the rather startling conclusion that one might 'get a change of law as a bonus for a change of venue.'" *Van Dusen,* 376 U.S. at 636, 84 S.Ct. at 819 (quoting *Wells v. Simonds Abrasive Co.,* 345 U.S. 514, 522, 73 S.Ct. 856, 860, 97 L.Ed. 1211 (1953) (Jackson, J. dissenting)). Accordingly, we hold the law of the Third Circuit, as the transferor forum, supplies the appropriate limitations period in this case. We note however the decision that *Van Dusen* and *Ferens* apply in this case is a narrow one based on the unique language and purpose of 15 U.S.C. § 78aa-1. Nothing in our decision should be read to imply *Van Dusen* and *Ferens* have any broad applicability to federal question jurisdiction cases generally.

B.

Having decided we are bound to apply Third Circuit law, we must determine our sister circuit's limitations period as of June 19, 1991. The answer to this query lies in *Data Access.* After exhaustively summarizing and analyzing the murky terrain concerning the proper limitations period for Rule 10b-5, the court concluded, "the express limitations sections of the Securities Exchange Act of 1934 provide the preferable source of limitations borrowing here." *Data Access,* 843 F.2d at 1550. The court held:

> the proper period of limitations for a complaint charging violation of section 10(b) and Rule 10b-5 is one year after the plaintiff discovers the facts constituting the violation, and in no event more than three years after such violation.

Id.

Because Mr. Olcott filed his claim in 1982, our next inquiry is whether *Data Access* should apply retroactively. The district court concluded it should, after applying the three-part test from *Chevron Oil Co. v. Huson,* 404 U.S. 97, 105-07, 92 S.Ct. 349, 354-55, 30 L.Ed.2d 296 (1971). We agree with the district court's ultimate conclusion, albeit with a slightly different analysis.

The Supreme Court has modified the appropriate retroactivity analysis since *Chevron* was decided nearly a quarter century ago. In *Beam,* a divided Court concluded selective prospectivity had no place in the civil context. 501 U.S. at 544, 111 S.Ct. at 2448; *id.* at 545-46, 111 S.Ct. at 2448-49 (White, J. concurring in the judgment); *id.* at 547-48, 111 S.Ct. at 2449-50 (Blackmun, J. concurring in the judgment); *id.* at 548-49, 111 S.Ct. at 2450 (Scalia, J.

concurring in the judgment).[8] Subsequently, the Court has stated:

> [W]e accordingly adopt a rule that fairly reflects the position of a majority of Justices in *Beam:* When this Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate our announcement of the rule.

Harper v. Virginia Dept. of Taxation, 509 U.S. 86, ___, 113 S.Ct. 2510, 2517, 125 L.Ed.2d 74 (1993); *see also Plaut,* ___ U.S. at ___, 115 S.Ct. at 1450 ("A new rule of federal law that is applied to the parties in the case announcing the rule must be applied as well to all cases pending on direct review.").[9] Further, in *Beam,* the plurality addressed the continued validity of *Chevron:*

> Because the rejection of modified prospectivity precludes retroactive application of a new rule to some litigants when it is not applied to others, the *Chevron Oil* test cannot determine the choice of law by relying on the equities of the particular case. Once retroactive application is chosen for any assertedly new rule, it is chosen for all others who might seek its prospective

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[8] *Beam* spawned two different broad viewpoints on the prospective application of new federal rules. One group of three justices concluded new civil rules should always be applied retroactively (Blackmun, Marshall, and Scalia, JJ.). Another group of three justices concluded selective prospectivity was wrong, but pure prospectivity might be appropriate with some new civil rules (Souter, Stevens, and White, JJ.).

[9] The Court's decisions mirror its earlier holding that selective prospectivity would no longer occur in criminal cases. *Griffith v. Kentucky,* 479 U.S. 314, 328, 107 S.Ct. 708, 716, 93 L.Ed.2d 649 (1987).

> application. The applicability of rules of law is not to be switched on and off according to individual hardship; . . .

Beam, 501 U.S. at 543, 111 S.Ct. at 2447-48. As a result of *Beam,* the analysis of *Chevron* is only relevant, if it maintains any relevance at all, in determining whether a new federal rule should apply retroactively across the board. No longer may *Chevron* be used to make individual retroactivity determinations on a case by case equitable basis.

We believe *Beam* and *Harper* apply to the instant case. Accordingly, if the new federal rule announced in *Data Access* has previously been applied retroactively, it must also be applied retroactively here.

The Third Circuit first addressed whether its new rule should apply retroactively in *Data Access* itself. The court explicitly declined to address whether the new limitations period should apply retroactively to the *Data Access* plaintiffs. The court relied on the fact "[i]n certifying the questions for our consideration [pursuant to 28 U.S.C. § 1292(b)], the district court did not request that we address the issue of whether our rulings should have prospective effect only and not apply to the present case." *Data Access,* 843 F.2d at 1550. The court left the resolution of this issue to the district court. *Id.* at 1551. The court's refusal to address the retroactivity issue prompted three members of the court to dissent. The dissent applied *Chevron* and concluded, "the rule announced today [should] not be applied to this case." *Id.* at 1553 (Seitz, J.

dissenting).[10] However, four ensuing Third Circuit cases have had no difficulty applying *Data Access* retroactively. *Westinghouse Elec. Corp. v. Franklin,* 993 F.2d 349, 354-56 (3d Cir.1993); *McCarter v. Mitcham,* 883 F.2d 196, 201-05 (3d Cir.1989); *Gatto v. Meridian Medical Assoc., Inc.,* 882 F.2d 840, 842-44 (3d Cir.1989), *cert. denied,* 493 U.S. 1080, 110 S.Ct. 1136, 107 L.Ed.2d 1041 (1990); *Hill v. Equitable Trust Co.,* 851 F.2d 691, 695-99 (3d Cir.1988), *cert. denied,* 488 U.S. 1008, 109 S.Ct. 791, 102 L.Ed.2d 782 (1989). Only one Third Circuit opinion determined, after applying *Chevron,* that *Data Access* should not apply retroactively to that particular plaintiff. *Gruber v. Price Waterhouse,* 911 F.2d 960, 964-69 (3d Cir.1990). Mr. Olcott relies upon *Gruber* and two district court cases which refused to apply *Data Access* retroactively after applying *Chevron. In re National Smelting of New Jersey, Inc. Bondholders' Litig.,* 722 F.Supp. 152 (D.N.J.1989); *Newfield v. Shearson Lehman Bros.,* 699 F.Supp. 1124 (E.D.Pa.1988). These cases decided under *Chevron* are inapposite to our analysis under *Beam.* We believe *Beam* requires the retroactive application of *Data Access* in this case because the Third

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[10] *But compare Gatto v. Meridian Medical Assoc., Inc.,* 882 F.2d 840, 843 n. 4 (3d Cir.1989) ("Often overlooked is the fact that the majority in *Data Access* in effect applied the result retroactively, which is evident because it was disagreement with that silent portion of the holding which prompted the dissent."), *cert. denied,* 493 U.S. 1080, 110 S.Ct. 1136, 107 L.Ed.2d 1041 (1990) *with Gruber v. Price Waterhouse,* 911 F.2d 960, 964 (3d Cir.1990) ("Because the application of our ruling was not requested in the question certified to us in *Data Access,* we did not decide whether the decision should be applied retroactively. We reserved this determination for the district court."). It appears a disagreement exists among the judges of the Third Circuit on the proper interpretation of *Data Access* on this issue.

Circuit has applied its new rule retroactively on four occasions.

C.

We now apply *Data Access'* one-year/three-year limitations period to the facts of Mr. Olcott's case. Initially, the timeliness of Mr. Olcott's claims is judged against the three-year statute of repose. In *Lampf,* the Supreme Court described this three-year time period as an outside limit and declined to apply equitable tolling principles to extend it. 501 U.S. at 364, 111 S.Ct. at 2782. The Court wrote:

> The 1-year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary. The 3-year limit is a period of repose inconsistent with tolling. One commentator explains: "[T]he inclusion of the three-year period can have no significance in this context other than to impose an outside limit." . . . Because the purpose of the 3-year limitation is clearly to serve as a cutoff, we hold that tolling principles do not apply to that period.

Id. (citations omitted). *See generally United States v. Kubrick,* 444 U.S. 111, 117, 100 S.Ct. 352, 356, 62 L.Ed.2d 259 (1979) (describing the nature of statutes of limitations and statutes of repose.)[11] Accordingly, Mr. Olcott's claims

[11] While we are applying Third Circuit law in addressing this issue, our discussion in *Anixter I* is directly on point. *See Anixter I,* 939 F.2d at 1434-36 (discussing the unavailability of employing equitable tolling principles to extend a statute of repose). *See also Waller v. Pittsburgh Corning Corp.,* 946 F.2d 1514, 1515 n. 1 (10th Cir.1991) ("Statutes of limitation bar a claim after a time period that begins to run when the cause of action accrues. Statutes of repose, on the other hand, bar a

(Continued on following page)

based on his 1976, 1977, and 1978 limited partnership investments are time barred because they were not filed until 1982, more than three years after the underlying events giving rise to the violation occurred. In contrast, Mr. Olcott's claim arising from his 1979 investment was filed within the requisite three years. However, the question remains whether Mr. Olcott brought his Rule 10b-5 cause of action within the one year statute of limitations period.

The district court concluded Mr. Olcott had sufficient notice more than one year prior to July 9, 1982, when he filed his securities fraud lawsuit. The district court held, "evidence of Plaintiff's suspicions about the 1979 investment within the one-year limitation period establish that his claim arising out of that investment is barred by the one-year rule." Unfortunately, the district court failed to offer any specific facts to support this conclusion. Therefore, we have no basis to evaluate the court's holding and must remand for the court to explain its factual determination. At this point, the factual record is insufficiently developed for us to determine when the statute of limitations began to run in this case.

On remand, the district court must determine when Mr. Olcott had notice of the underlying "facts constituting the violation." *Lampf,* 501 U.S. at 364, 111 S.Ct. at 2782; *Data Access,* 843 F.2d at 1550. Inquiry notice of the underlying facts giving rise to a potential Rule 10b-5 cause of action is sufficient. *Gruber,* 911 F.2d at 969. The statute of

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claim after a period that is triggered by an arbitrary event unrelated to the accrual of the cause of action.").

limitations period accrued when Mr. Olcott knew or should have known of the Rule 10b-5 violation. *Id.* at 962. *See also In re Phar-Mor, Inc., Sec. Litig.*, 900 F.Supp. 777, 780-81 (W.D.Pa.1994); *ITG, Inc. v. Price Waterhouse,* 697 F.Supp. 867, 870-71 (E.D.Pa.1988).[12] We remind the district court the determination of when Mr. Olcott had notice of the underlying events requires an evidentiary finding. As a result, resolving the notice issue in the procedural context of a motion to dismiss is wrong. We believe it would be more appropriate to make the necessary determination on summary judgment, or, if a genuine issue of material fact remains in dispute, after an evidentiary hearing.

In summary, we hold Mr. Olcott's claims based on his 1976, 1977, and 1978 investments are time barred because he failed to file within the applicable three-year statute of repose. However, we remand to the district court to determine exactly when Mr. Olcott possessed inquiry notice of the underlying events giving rise to his claim relating to his 1979 investment. Such a factual finding on remand is a necessary prerequisite for determining whether Mr. Olcott's remaining claim is time barred by the one-year statute of limitations.

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[12] Other circuits, including this one, have also adopted inquiry notice as the appropriate standard for triggering when the one-year statute of limitations period begins to accrue. *See, e.g., Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 609-10 (7th Cir.1995); *Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co.*, 32 F.3d 697, 700-01 (2d Cir.1994); *Anixter v. Home-Stake Prod. Co.*, 947 F.2d 897, 898-99 (10th Cir.1991).

III.

Next, Mr. Olcott argues the district court erred in dismissing his pendent state law claims after having dismissed his federal claims. The district court dismissed the pendent claims after reasoning: "The Court finds that because complete diversity of citizenship does not exist as to the state pendent claims, these claims must also be dismissed." We agree with Mr. Olcott the court improvidently dismissed these claims at this stage of the litigation.

As an initial matter, we are confronted with another difficult choice of law issue. We must determine whether Third Circuit or Tenth Circuit law provides the appropriate standard for reviewing the district court's dismissal of Mr. Olcott's pendent claims. We believe Third Circuit law applies for the reasons discussed in Part IIA above. However, in this context, the choice of law question has only academic rather than transactional significance because both circuits employ the same test.

We review the district court's dismissal of the pendent state claims for an abuse of discretion. *Big Apple BMW, Inc. v. BMW of North America, Inc.*, 974 F.2d 1358, 1362 (3d Cir.1992), *cert. denied*, 507 U.S. 912, 113 S.Ct. 1262, 122 L.Ed.2d 659 (1993); *Cooley v. Pennsylvania Housing Fin. Agency*, 830 F.2d 469, 476 (3d Cir.1987). A district court has discretion whether to exercise supplemental jurisdiction over state law claims once the federal question has been dismissed. 28 U.S.C. § 1367(c). "In making its determination, the district court should take into account generally accepted principles of 'judicial economy, convenience, and fairness to the litigants.'" *Growth Horizons, Inc. v. Delaware County, Pa.*, 983 F.2d 1277, 1284 (3d Cir.1993)

(quoting *United Mine Workers v. Gibbs,* 383 U.S. 715, 726, 86 S.Ct. 1130, 1139, 16 L.Ed.2d 218 (1966)). In addition, the court should consider the particular circumstances of the case including the nature and extent of the pretrial proceedings. *Id.* at 1284-85 and n. 13.[13] This multifactorial analysis has been called death knell analysis. *Cooley,* 830 F.2d at 475.

Our remand of Mr. Olcott's 1979 claim for further factual findings reestablishes federal question jurisdiction. Therefore, depending on the resolution of the notice issue, a jurisdictional basis may ultimately exist to support supplemental jurisdiction over Mr. Olcott's state claims. However, even if on remand Mr. Olcott's Rule 10b-5 claim is ultimately dismissed in its entirety, the district court erred in the manner in which it dismissed Mr. Olcott's pendent state claims. The court abused its discretion by failing to conduct the appropriate death knell analysis to determine if it should retain jurisdiction over the pendent state claims despite having previously dismissed the federal cause of action.

Finally, we offer the district court some additional guidance for its task on remand. On several occasions, the Third Circuit has affirmed a district court's decision to retain supplemental jurisdiction over pendent state claims after having dismissed the federal cause of action. *See, e.g., In re Paoli R.R. Yard PCB Litig.,* 35 F.3d 717, 737-38 (3d Cir.1994), *cert. denied,* ___ U.S. ___, 115 S.Ct. 1253,

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[13] As noted above, we have adopted an identical rule. *See Anglemyer v. Hamilton County Hosp.,* 58 F.3d 533, 541 (10th Cir.1995); *Thatcher Enterprises v. Cache County Corp.,* 902 F.2d 1472, 1478 (10th Cir.1990).

131 L.Ed.2d 134 (1995); *Lentino v. Fringe Employee Plans, Inc.*, 611 F.2d 474, 480 (3d Cir.1979). We believe these precedents should lead the district court to carefully examine the nature of the pretrial activities which occurred in this case. In particular, the fairness to Mr. Olcott in dismissing his pendent state claims depends in large measure on whether any opportunity remains for him to bring them in New Jersey state court at this late date. The district court should determine how much of the lengthy delay in this litigation is attributable to changes in the applicable law, and how much is due to the defendants' recalcitrance in failing to submit the complete accounting. If the majority of the delay is attributable to the defendants' sanctionable conduct the equities may favor Mr. Olcott, allowing him to proceed with his state claims in federal court.

IV.

In addition, both parties appeal the district court's sanctions order. The defendants challenge the district court's jurisdiction to impose a sanction of $402,527.98 after having dismissed Mr. Olcott's lawsuit. The defendants also argue the district court abused its discretion in sanctioning them. Mr. Galesi specifically asserts the district court abused its discretion because "the findings leading to the [sanctions] order are totally unsupported by the evidence." In turn, Mr. Olcott requests we exercise our inherent authority to reduce the district court's $1.9 million default judgment order to a binding judgment against the defendants.

A.

This seven-year accounting dispute began on March 18, 1986, when, as part of a stipulated pretrial scheduling order, the defendants agreed to:

> furnish plaintiff with a full, complete, meaningful, and formal accounting of all of the financial affairs of [the four limited partnerships], setting forth all items of contribution, income, and expense as well as the disposition of all assets and monies, for each of the four limited partnerships, including a full and complete accounting for all monies paid by each of the partnerships under the turnkey drilling contracts. . . .

An interim status report on the accounting was due within ninety days, and the accounting itself was due in six months. The defendants missed both deadlines. When the accounting was ultimately filed on January 13, 1987, Mr. Olcott challenged its sufficiency. The court's appointed expert accountant, Mr. Charles H. Ostrander, CPA, found the accounting inadequate. After an evidentiary hearing, the district court concluded in a March 17, 1987 order the accounting failed to comply with the stipulation and ordered the defendants to file a supplemental accounting. Because of the deficiencies, the court ordered the defendants to "pay all costs and fees incurred by the Plaintiff from December 19, 1986 regarding the accounting issues until all accounting issues are resolved."

On May 12, 1987, the defendants filed their first supplemental accounting. Mr. Olcott again objected, and the court's expert agreed the accounting remained insufficient. After another hearing, the district court found the supplemental accounting deficient. In an October 14, 1987 order, the court addressed the issue of sanctions against the defendants. Initially, the court found there was not

"sufficient evidence of bad faith on the part of the Defendants to justify the imposition of default judgment," at this time. However, the court reiterated its sanctions order. The court ordered the defendants to pay Mr. Olcott's attorney's fees and expert expenses related to litigating the sufficiency of the accounting pursuant to Fed.R.Civ.P. 16 and 37(b). The court warned the individual defendants they would be subject to "the full panoply of sanctions for noncompliance" with the court's accounting orders. Finally, the court rejected Mr. Olcott's request to impose sanctions pursuant to Fed.R.Civ.P. 11 or 28 U.S.C. § 1927 against the defendants' counsel.

After two extensions, on April 15, 1988, the defendants filed their second supplemental accounting. Again, Mr. Olcott contested its sufficiency. The court's expert again found the accounting wanting. After a third hearing, in a February 8, 1990 order, the court found under the totality of the circumstances the defendants noncompliance with its accounting orders was willful. The court based this factual finding on the testimony of two of Mr. Galesi's former counsels whose firm withdrew after Mr. Galesi failed to comply with the accounting orders. Counsel testified Mr. Galesi, "had told him that he would never render an accounting to the Plaintiffs." After making these findings of fact, the court concluded the defendants' noncompliance constituted a bad faith refusal to comply with the court's accounting orders as a matter of law. As a result, the court determined a default judgment was the appropriate sanction for the defendants' continued abuse of the legal process. The court concluded:

> Plaintiff is entitled to a judgment against the Defendants, jointly and severally, for his investment of $1.9 million dollars [sic] less any portion of those funds

> which Defendants can establish were utilized for legitimate purposes under the terms and provisions of the Limited Partnership Agreements. There will be a trial at which the burden will be upon the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties.

Following this order, the issue remained dormant during the litigation of the limitations period question. The court revisited the sanctions issue in an April 30, 1993 order, concluding it possessed the jurisdiction to impose sanctions against the defendants despite having dismissed Mr. Olcott's lawsuit. The court reasoned:

> In the case at bar, this Court relied upon the authority conferred by Rules 16 and 37, Fed.R.Civ.P. in its October 14th order. Is the order in the nature of a sanction or of civil contempt? A review of the Order in light of the record reveals that it is both: it sought both to sanction the past behavior of the Defendants in impeding the judicial process and to impel them to mend their ways in the future. . . . [T]he sanction order was precipitated by a pattern of recalcitrance by Defendants, which the Court attempted to punish *and* forestall. A fair reading of the October 14th Order compels the conclusion that the Order was a hybrid of civil contempt and of sanctions. . . .
>
> On this record, it seems beyond peradventure that the October 14th Order was, in part, analogous to a Rule 11 sanction for frustrating and impeding the judicial process. And this Court specifically so finds. The Court, therefore, concludes that, in spite of the fact that the Order had a civil contempt component, it was nonetheless an authorized exercise of its powers pursuant to *Willy.* The Order is, thus, enforceable.

The court earlier had referred the amount of the attorney's fees and accounting expenses to a magistrate for a report and recommendation. The magistrate issued two reports on the amount of the sanction which totalled $388,252.98. The court adopted the magistrate's recommendation. In addition, the court required the defendants to pay the $14,275 fee of the court's expert accountant for a total award of $402,527.98. In its final sanctions order the court neglected to mention the $1.9 million default judgment against the defendants.

B.

In their cross-appeal, the defendants contest the district court's jurisdictional basis for levying the sanction. The district court imposed its sanction pursuant to Fed.R.Civ.P. 16(f) and 37(b). The court reasoned while its sanctions order was a hybrid of a civil contempt citation and Fed.R.Civ.P. 11, its predominate purpose was punitive in response to the defendants' continued recalcitrance in failing to submit a complete and meaningful accounting. The court concluded its order was most analogous to a Rule 11 sanction and was therefore enforceable. We agree.

As the district court recognized, the Supreme Court has distinguished between civil contempt and Rule 11 sanctions. Broadly speaking, in the absence of subject-matter jurisdiction, Rule 11 sanctions are enforceable while a civil contempt citation is not. *Compare Willy v. Coastal Corp.*, 503 U.S. 131, 112 S.Ct. 1076, 117 L.Ed.2d 280 (1992) *with United States Catholic Conference v. Abortion Rights Mobilization, Inc.*, 487 U.S. 72, 108 S.Ct. 2268, 101 L.Ed.2d 69 (1988). The parties offer opposing characterizations of the district court's sanction in an

effort to analogize them to either *Willy* or *Catholic Conference*. We examine these Supreme Court precedents and the nature and purpose of the sanction to determine which analogy represents the better fit.

In *Catholic Conference,* the Court examined the parameters of enforcing civil contempt citations. The underlying dispute concerned Abortion Rights Mobilization's (ARM) lawsuit seeking to revoke the tax exempt status of the Catholic Church of the United States based on the Church's alleged improper political participation on the abortion issue. *Catholic Conference,* 487 U.S. at 74-75, 108 S.Ct. at 2269-70. During the course of the litigation, ARM served subpoenas *duces tecum* against two nonparties, the United States Catholic Conference and the National Conference of Catholic Bishops, in an effort to discover documentation supporting its claims. The two organizations refused to comply with the subpoenas, and the district court held them in civil contempt. *Id.* The Court held the contempt citation was unenforceable, reasoning:

> a nonparty witness can challenge the court's lack of subject-matter jurisdiction in defense of a civil contempt citation, notwithstanding the absence of a final judgment in the underlying action. Federal Rule of Civil Procedure 45 grants a district court the power to issue subpoenas as to witnesses and documents, but the subpoena power of a court cannot be more extensive than its jurisdiction. It follows that if a district court does not have subject-matter jurisdiction over the underlying action, and the process was not issued in aid of determining that jurisdiction, then the process is void and an order of civil contempt based on refusal to honor it must be reversed.

Id. at 76, 108 S.Ct. at 2270. As a result, the Court concluded the district court's civil contempt citation was not enforceable against the Conferences unless the court "had subject-matter jurisdiction in the underlying action." *Id.* at 80, 108 S.Ct. at 2272. The Court remanded the case for this determination to be made. *Id.* If no subject-matter jurisdiction ultimately existed, "then the subpoenas *duces tecum* are void, and the civil contempt citation must be reversed 'in its entirety.'" *Id.* at 80, 108 S.Ct. at 2272-73 (quoting *United States v. United Mine Workers of Am.*, 330 U.S. 258, 295, 67 S.Ct. 677, 697, 91 L.Ed. 884 (1947)).

In contrast, in *Willy,* the Court concluded Rule 11 sanctions could be enforced despite a lack of subject-matter jurisdiction. Originally, Mr. Willy sued Coastal Corporation in Texas state court for claims arising from the termination of his employment. *Willy,* 503 U.S. at 132-34, 112 S.Ct. at 1078. Coastal Corporation removed the case to federal court claiming federal question jurisdiction. Over Mr. Willy's objection, the district court concluded it possessed subject-matter jurisdiction. Subsequently, the district court dismissed the case for failing to state a claim, and also imposed Rule 11 sanctions against Mr. Willy and his attorney. On appeal, the Fifth Circuit concluded the district court lacked subject-matter jurisdiction, but upheld the Rule 11 sanctions. *Id.* The Court upheld the Rule 11 sanctions, explaining:

> A final determination of lack of subject-matter jurisdiction of a case in a federal court, of course, precludes further adjudication of it. But such a determination does not automatically wipe out all proceedings had in the district court at a time when the district court operated under the misapprehension that it had jurisdiction.

Id. at 137, 112 S.Ct. at 1080. Among the collateral issues a federal court may consider after an action is no longer pending is a Rule 11 sanction. *Id.* A court may do so because the "imposition of a Rule 11 sanction is not a judgment on the merits of an action. Rather, it requires the determination of a collateral issue: whether the attorney has abused the judicial process, and, if so, what sanction would be appropriate." *Id.* (quoting *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 396, 110 S.Ct. 2447, 2456, 110 L.Ed.2d 359 (1990)).

Importantly for our present purposes, the Court in *Willy* distinguished its earlier decision in *Catholic Conference.* The Court criticized Mr. Willy's reliance on *Catholic Conference* "as establishing the proposition that a sanction must fall if imposed when jurisdiction is in fact absent." *Willy,* 503 U.S. at 138, 112 S.Ct. at 1081. In response, the Court stated:

> *Catholic Conference* does not stand for such a broad assertion. A civil contempt order has much different purposes than a Rule 11 sanction. Civil contempt is designed to force the contemnor to comply with an order of the court; Rule 11 is designed to punish a party who has already violated the court's rules. Given that civil contempt is designed to coerce compliance with the court's decree, it is logical that the order itself should fall with a showing that the court was without authority to enter the decree.
>
> The interest in having rules of procedure obeyed, by contrast, does not disappear upon a subsequent determination that the court was without subject-matter jurisdiction. . . . [T]here is no constitutional infirmity under Article III in requiring those practicing before the courts to conduct themselves in compliance with the applicable procedural rules in the interim,

> and to allow the courts to impose Rule 11 sanctions in the event of their failure to do so.

Id. (citations and footnotes omitted).

We conclude the district court's sanction imposed pursuant to Rule 16(f) and 37(b) is sufficiently analogous to Rule 11 sanctions to be enforced despite a lack of subject-matter jurisdiction. The analogy to *Willy* simply provides a better fit than *Catholic Conference.* The predominant purpose of the two rules invoked by the district court is to punish litigants and attorneys for their noncompliance with pretrial and discovery orders. An analysis of the text of the two rules and case law interpreting them clarify this intent.

First, the texts and plain meaning of Rule 16(f) and Rule 37(b) complement Rule 11.[14] The three rules share a

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[14] To facilitate our analysis, we have set forth the texts of the three rules in the margin. First, Rule 16(f) provides:

> **Fed.R.Civ.P. 16(f) Sanctions**. If a party or party's attorney fails to obey a scheduling or pretrial order, or if no appearance is made on behalf of a party at a scheduling or pretrial conference, or if a party or party's attorney is substantially unprepared to participate in the conference, or if a party or party's attorney fails to participate in good faith, the judge, upon motion or the judge's own initiative, may make such orders with regard thereto as are just, and among others any of the orders provided in Rule 37(b)(2)(B), (C), (D). In lieu of or in addition to any other sanction, the judge shall require the party or the attorney representing the party or both to pay the reasonable expenses incurred because of any noncompliance with this rule, including attorney's fees, unless the judge finds that the noncompliance was substantially justified or that other circumstances make an award of expenses unjust.

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Second, Rule 37(b)(2) provides:

> **Fed.R.Civ.P. 37(b)(2) Sanctions by Court in Which Action is Pending.** If a party or an officer, director, or managing agent of a party or a person designated under Rule 30(b)(6) or 31(a) to testify on behalf of a party fails to obey an order to provide or permit discovery, including an order made under subdivision (a) of this rule or Rule 35, or if a party fails to obey an order entered under Rule 26(f), the court in which the action is pending may make such orders in regard to the failure as are just, and among others the following:
>
> (A) An order that the matters regarding which the order was made or any other designated facts shall be taken to be established for the purposes of the action in accordance with the claim of the party obtaining the order;
>
> (B) An order refusing to allow the disobedient party to support or oppose designated claims or defenses, or prohibiting that party from introducing designated matters in evidence;
>
> (C) An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party;
>
> (D) In lieu of any of the foregoing orders or in addition thereto, an order treating as a contempt of court the failure to obey any orders except an order to submit to a physical or mental examination;
>
> (E) Where a party has failed to comply with an order under Rule 35(a) requiring that party to produce another for examination, such orders as are listed in paragraphs (A), (B), and (C) of this subdivision, unless the party failing to comply shows that that party is unable to produce such person for examination.
>
> In lieu of any of the foregoing orders or in addition thereto, the court shall require the party failing to obey the order or the attorney advising that party or both to pay the reasonable expenses, including attorney's fees, caused by the failure, unless the court finds that the failure was substantially justified or that other circumstances make an award of expenses unjust.

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common purpose, which they seek to achieve by employing substantially similar operative language. For example, all three rules use the term sanctions. While sanctions has become a generic legal term, the Federal Rules maintain a clear distinction between sanctions and civil contempt. Various rules use the two terms for different purposes. *Compare* Rule 11, Rule 16(f), Rule 26(g)(3), Rule 37(a)(4) and Rule 37(b)(2) (sanctions) *with* Rule 4.1(b), Rule 37(b)(2)(D), Rule 45(e), and Rule 56(g) (contempt). These differences indicate the drafters of the Federal Rules knew and appreciated the distinction between sanctions and civil contempt. The rules do not use the two terms of art interchangeably. Further, all three rules provide the court the discretionary option of awarding reasonable attorney's fees and costs resulting from the rule violation. The district court's discretion allows it to depart from the traditional rule of each party paying its own litigation costs, expenses and attorney's fees. *See generally* Fed.R.Civ.P. 54(d); *Alyeska Pipeline Serv. Co., v. Wilderness Soc'y,* 421 U.S. 240, 95 S.Ct. 1612, 44 L.Ed.2d 141 (1975); *Aguinaga v. United Food & Commercial Workers Int'l Union,* 993 F.2d 1480 (10th Cir.1993). This departure from

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Finally, Rule 11(c)(2) provides:

> **Fed.R.Civ.P. 11(c)(2) Nature of Sanction; Limitations.** A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated. Subject to the limitations in subparagraphs (A) and (B), the sanction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation.

the American Rule demonstrates the punitive nature of the sanctions of the three rules.

Finally, the three rules grant district courts substantial discretion to craft their orders to serve the interests of justice. Both Rule 16(f) and Rule 37(b)(2) require the court to keep considerations of justice in mind when imposing sanctions for rule violations. The two rules provide a list of potential options for the court's consideration, including costs and fee shifting, but ultimately leave it to the court's discretion to "make such orders . . . as are just." *See, e.g., Insurance Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee,* 456 U.S. 694, 707, 102 S.Ct. 2099, 2107, 72 L.Ed.2d 492 (1982) ("Rule 37(b)(2) contains two standards – one general and one specific – that limit a district court's discretion. First, any sanction must be 'just'; second, the sanction must be specifically related to the particular 'claim' which was at issue in the order to provide discovery.") Similarly, Rule 11(c) includes justice as a consideration by requiring courts to impose an "appropriate sanction." And Rule 11(c)(2) adds the additional related consideration of deterring similar sanctionable conduct in the future. These textual similarities among Rule 16(f), Rule 37(b) and Rule 11 help establish their similar design and purpose. All three rules were designed to enforce compliance with the applicable procedural rules at different stages of federal court litigation. *See, e.g., Jones v. Thompson,* 996 F.2d 261, 264 (10th Cir.1993) (describing how the Federal Rules and the court's inherent powers provide "ample tools to deal with a recalcitrant litigant," at the different stages of litigation).

Case law interpreting both Rule 16(f) and Rule 37(b) provides additional support for our conclusion the rules

serve a predominantly punitive purpose. The Supreme Court has declared:

> Both parties and counsel may be held personally liable for expenses, "including attorney's fees," caused by the failure to comply with discovery orders. Rule 37 sanctions must be applied diligently both "to penalize those whose conduct may be deemed to warrant such a sanction, [and] to deter those who might by tempted to such conduct in the absence of such a deterrent."

Roadway Express, Inc. v. Piper, 447 U.S. 752, 763-64, 100 S.Ct. 2455, 2462-63, 65 L.Ed.2d 488 (1980) (footnote omitted) (quoting *National Hockey League v. Metropolitan Hockey Club, Inc.,* 427 U.S. 639, 643, 96 S.Ct. 2778, 2781, 49 L.Ed.2d 747 (1976) (per curiam)). We have also noted the punitive nature of Rule 37(b)(2) sanctions. *State of Ohio v. Arthur Andersen & Co.,* 570 F.2d 1370, 1375 (10th Cir.), *cert. denied,* 439 U.S. 833, 99 S.Ct. 114, 58 L.Ed.2d 129 (1978). *See generally* Wright, Miller & Marcus, *Federal Practice and Procedure: Civil 2d* §§ 2282-84. Similarly, while the Court has not addressed the issue, we have previously recognized the punitive purpose of Rule 16(f). In *Matter of Sanction of Baker,* 744 F.2d 1438 (10th Cir.1984) (en banc), *cert. denied,* 471 U.S. 1014, 105 S.Ct. 2016, 85 L.Ed.2d 299 (1985), we offered the following description:

> While on the whole Rule 16 is concerned with the mechanics of pretrial scheduling and planning, its spirit, intent and purpose is clearly designed to be broadly remedial, allowing courts to actively manage the preparation of cases for trial. . . . [T]here can be no doubt that subsection (f), added as part of the 1983 amendments to Rule 16, indicates the intent to give courts very broad discretion to use sanctions where

> necessary to insure not only that lawyers and parties refrain from contumacious behavior, already punishable under the various other rules and statutes, but that they fulfill their high duty to insure the expeditious and sound management of the preparation of cases for trial.

Id. at 1440. Further, the *Baker* court identified the two complementary purposes of the rule. "The primary purpose of sanctions in this context is to insure reasonable management requirements for case preparation. The secondary purpose is to compensate opposing parties for inconvenience and expense incurred because of any noncompliance with the reasonable management orders of the court." *Id.* at 1441; *G.J.B. & Assoc., Inc. v. Singleton,* 913 F.2d 824, 831 (10th Cir.1990). *See generally* Wright, Miller & Kane, *Federal Practice and Procedure: Civil 2d* § 1531. In *Baker,* the court recognized sanctions imposed pursuant to Rule 16(f) were, at least in part, designed to punish noncompliance with pretrial orders.

In addition, the defendants challenge the applicability of both Rule 16(f) and Rule 37(b) to the accounting order at issue here. First, they contend Rule 16(f) is inapplicable because the accounting order reached the merits of Mr. Olcott's case and was not concerned with "the mechanics of pretrial conferences and scheduling." *Baker,* 744 F.2d at 1441. Second, the defendants argue Rule 37(b) is also inapposite because "no federal discovery rule even approaches the scope or depth of the District Court's accounting orders here." Again, we disagree.

We believe the district court's reliance on both Rule 16(f) and Rule 37(b) was logical and appropriate under the circumstances. Originally, the defendants consented to provide Mr. Olcott with the accounting. The parties'

agreement was memorialized in the district court's Supplementary Scheduling Order of March 18, 1986. Presumably, one rationale for including the accounting agreement as part of a pretrial scheduling order was the specific deadlines for filing both the interim status report and the accounting itself. Under the terms of the agreement, the district court was responsible for enforcing compliance. We disagree with the defendants that the accounting was made part of the pretrial order merely "for convenience only." Instead, we believe the district court properly included the accounting in its pretrial order "to insure early judicial intervention in the process of trial preparation and proper conduct of that entire process." *Id.* The court's inclusion of the accounting in the pretrial order allowed it to enforce the procedural deadlines agreed to by the parties.[15] The fact the accounting became central to the parties' pretrial disputes vindicates the district court's decision.

The district court's reason for attempting to enforce the defendants' obligation to provide the accounting through Rule 37(b)(2) is even clearer. Mr. Olcott sought an agreement about the accounting for the purpose of discovery. The central question posed by Mr. Olcott's Rule 10b-5 lawsuit was what happened to the money he invested. His allegation of fraud centered on the defendants' alleged improper allocation of this money either to activities ultra vires to the limited partnership agreements or the defendants' improper commingling of partnership assets. Thus, an accounting was necessary for Mr. Olcott to prove fraud.

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[15] As we make clear below, the district court was also able to enforce the substance of the parties' agreement through Rule 37(b)(2).

Further, the record indicates Mr. Olcott unsuccessfully attempted to employ more traditional discovery options. He turned to an accounting after it became increasingly clear depositions, interrogatories, document requests, and requests for admissions would not provide the necessary answers. Under these circumstances, we agree with the district court the accounting was a discovery device making enforcement pursuant to Rule 37(b)(2) appropriate.

We believe the combination of Rule 16(f) and Rule 37(b) supports the district court's imposition of the sanction against the defendants. We reach this conclusion in part based on the broad principles of the Federal Rules and the purpose of the sanction. Recently, in a different context, we noted, "we see no principled distinction between sanctions imposed for discovery violations and sanctions imposed for noncompliance with other orders." *Mobley v. McCormick,* 40 F.3d 337, 340 (10th Cir.1994). We find no such distinction among Rule 16(f), Rule 37(b)(2), and Rule 11 here either. We believe the focus in this case should be on the defendants' lengthy noncompliance with the district court's orders. The seven-year accounting dispute expended far more judicial resources than should have been necessary. Mr. Olcott and the district court were forced to litigate the sufficiency of the accounting three times. These basic facts of the nature of this dispute should not be lost in a detailed legal analysis of which federal rules of civil procedure is the most appropriate vehicle for the district court's sanctions order. In this context, we find it appropriate to recall the point made by Chief Judge Murrah writing for this court almost thirty years ago. "The administration of the rules lies necessarily within the province of the trial court with power to fashion such orders as may be deemed proper to vouchsafe full

discovery for the just, speedy and inexpensive determination of the lawsuit." *Robison v. Transamerica Ins. Co.*, 368 F.2d 37, 39 (10th Cir.1966).

Accordingly, we hold the district court had jurisdiction under *Willy,* based on the punitive nature of Rule 16(f) and Rule 37(b)(2), to enforce the sanction of $402,527.98 against the defendants.

C.

Further, the defendants argue the district court abused its discretion by imposing a sanction against them for their failure to comply with the court's accounting orders. They assert their failure to submit a complete accounting "was unintentional and not worthy of sanction." Individually, Mr. Galesi maintains "the record here is absolutely devoid of credible evidence supporting findings that [he] willfully failed or refused to comply with the District Court's accounting orders."

We review the district court's sanctions order for an abuse of discretion. The identical standard of review applies for sanctions imposed pursuant to Rule 16(f) or Rule 37(b)(2). *Comcoa, Inc. v. NEC Telephones, Inc.*, 931 F.2d 655, 666 (10th Cir.1991); *Mobley,* 40 F.3d at 340. We accept the district court's factual findings underpinning its sanctions order unless clearly erroneous. *Ehrenhaus v. Reynolds,* 965 F.2d 916, 921 (10th Cir.1992); *Turnbull v. Wilcken,* 893 F.2d 256, 258 (10th Cir.1990) (per curiam).

In reviewing the district court's sanction, we examine the totality of the circumstances involved in the case. *Comcoa,* 931 F.2d at 666. Sanctions under Rule 16(f) and Rule 37(b)(2) must be in the interests of justice and

proportional to the specific violation of the rules. In discussing sanctions imposed pursuant to both rules, we have previously noted:

> The award of fees and expenses for noncompliance with the rules is discretionary, and the amount and impact of a monetary sanction should depend on the seriousness of the violation and where the fault lies, i.e. with counsel or client. However, in the absence of a finding of bad faith, there must be a sufficient nexus between noncompliance with the rules and the amount of fees and expenses awarded as a sanction.

Turnbull, 893 F.2d at 259 (citations omitted). More recently, in analyzing a Rule 37(b)(2) sanction we cautioned, "[t]he district court's discretion to choose a sanction is limited in that the chosen sanction must be both 'just' and 'related to the particular 'claim' which was at issue in the order to provide discovery.'" *Ehrenhaus,* 965 F.2d at 920-21 (quoting *Insurance Corp. of Ireland,* 456 U.S. at 707, 102 S.Ct. at 2107)).

The district court imposed a sanction against the defendants because their failure to submit a complete, meaningful accounting directly resulted in significant costs to the court and Mr. Olcott. The three evidentiary hearings required Mr. Olcott to pay his lawyers and hire expert accountants to evaluate the sufficiency of the defendants' accounting. Additionally, the court's expert was required to assess the accounting on each of the three occasions. The court imposed a sanction of $402,527.98 which equaled the total of Mr. Olcott's expenditures and the court's expert's fee.

Our review of the record convinces us that the court's sanction was both generally appropriate and proportionate

to the defendants' abuse of the legal process. The court expressly limited its sanction to those expenses and attorney's fees directly attributable to the defendants' sanctionable conduct. But for the defendants' actions, the funds to pay these costs would have been allocated differently. Here, we are not confronted with the situation where a court awarded the entire litigation costs of the adverse party as a sanction. *Turnbull,* 893 F.2d at 259. Instead, the sanction was specifically targeted to the litigation costs and fees associated with the defendants' failure to submit the accounting.

Both the defendants as a group, and Mr. Galesi individually, attack the district court's factual findings [sic] their failure to submit a sufficient accounting was willful and taken in bad faith. We give substantial deference to the district court's factual findings generally. However, "[w]here as here, a factual determination rests upon the credibility of a witness, Rule 52(a) demands even greater deference to the findings of the trial judge." *Robinson v. Audi Aktiengesellschaft,* 56 F.3d 1259, 1268 (10th Cir.1995) (citing *Anderson v. City of Bessemer City, N.C.,* 470 U.S. 564, 574, 105 S.Ct. 1504, 1511, 84 L.Ed.2d 518 (1985)), *cert. denied,* ___ U.S. ___, 116 S.Ct. 705, 133 L.Ed.2d 661 (1996).

The district court based its findings on the testimony of two of the defendants' former attorneys. They testified Mr. Galesi originally offered an accounting solely to obtain a continuance and never intended to fully comply with the court's accounting orders. While it is true Mr. Galesi vigorously disputed his prior counsels' testimony both before the district court and on appeal, the district court was certainly entitled to countenance the attorneys' version of the events over Mr. Galesi's. "Where there are

two permissible views of the evidence, the fact finder's choice between them cannot be clearly erroneous." *Metz v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 39 F.3d 1482, 1492 (10th Cir.1994) (quoting *Anderson*, 470 U.S. at 574, 105 S.Ct. at 1511). *See also Willner v. University of Kansas*, 848 F.2d 1023, 1030-32 (10th Cir.1988) (per curiam), *cert. denied*, 488 U.S. 1031, 109 S.Ct. 840, 102 L.Ed.2d 972 (1989). Faced with two versions of what happened, the district court was forced to make credibility determinations.

Having observed all the witnesses during the evidentiary hearings the district court rejected Mr. Galesi's position. We will not second-guess this decision on appeal. We believe sufficient evidence exists in the record to support the district court's determination Mr. Galesi and the other defendants acted willfully and in bad faith in failing to fully comply with the court's accounting orders. The district court did not abuse its discretion in imposing a sanction of $402,527.98 against the defendants.

D.

Finally, Mr. Olcott asks us to exercise our inherent authority to reduce the district court's $1.9 million default judgment order to a binding judgment against the defendants. As a threshold matter, we must address our own jurisdiction to review this issue. *City of Chanute, Kansas v. Williams Natural Gas Co.*, 31 F.3d 1041, 1045 n. 8 (10th Cir.1994), *cert. denied*, ___ U.S. ___, 115 S.Ct. 1254, 131 L.Ed.2d 135 (1995); *United States v. P.H.E., Inc.*, 965 F.2d 848, 850 (10th Cir.1992). Congress has granted the courts of appeals jurisdiction over all final decisions of the district courts. 28 U.S.C. § 1291. "The Supreme Court has

described a final decision as generally 'one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.'" *G.J.B. & Assocs.*, 913 F.2d at 827 (quoting *Catlin v. United States*, 324 U.S. 229, 233, 65 S.Ct. 631, 633, 89 L.Ed. 911 (1945)). There is no question a final decision has been reached on the merits of Mr. Olcott's lawsuit based on the district court's disposition of the defendants' motion to dismiss.

Even though we have jurisdiction to review the default judgment, we decline to do so because the district court's order leaves a final determination of the issue unresolved. The district court's failure to make a resolution of the default judgment is easily explained. The default judgment was part of the district court's order of February 8, 1990, which was issued prior to either of the court's dismissals in this case. The purpose of the default judgment was to coerce the defendants into completing the accounting for trial. The default judgment altered the burden of proof at trial so that the defendants would have to establish Mr. Olcott's $1.9 million investment was used properly. At trial, the defendants would be able to establish "the funds were utilized for legitimate purposes under the terms and provisions of the Limited Partnership Agreements." Mr. Olcott would receive whatever money the defendants failed to prove was properly invested. After the court dismissed Mr. Olcott's cause of action, the default judgment became moot because the court's decision abrogated the possibility of a trial. Indeed, the court's final sanction order neglects to mention the default judgment. We find this omission significant. This omission indicates the district court ultimately intended only to impose the Rule 16(f) and Rule 37(b)(2) sanctions against the defendants. Mr. Olcott may not appeal the district court's

decision to abandon the default judgment as a sanction because the court never entered a final order on this topic. We therefore decline to review the merits of this issue.

However, we note the district court may revisit the default judgment issue on remand. If the court ultimately revives Mr. Olcott's cause of action based on his 1979 investment, the court could take the opportunity to revisit the appropriateness of a default judgment at that time.

V.

In addition, the defendants appeal the district court's refusal to release $213,143 in funds held at Western National Bank in Tulsa, Oklahoma. The funds came under court supervision when the four limited partnerships sought court approval to sell some of their oil and natural gas assets. On February 22, 1990, the district court conditionally approved the sale by a brief minute order. The order does not explain its rationale for requiring the funds to be deposited and maintained under court supervision.

On November 6, 1991, the defendants requested the district court release the funds. The court took no action. On February 18, 1993, the defendants renewed their motion. The district court denied the motion in its April 30, 1993 order as follows:

> *The Renewed Motion of the Defendants for Post Judgment Relief* will be DENIED in its entirety. The motion may be reurged when the parties have complied with the directives and provisions of this Order.

The district court offered no additional explanation of why it retained these funds under court supervision on any subsequent occasion.

The district court's summary disposition of this issue renders it impossible for us to review the propriety of its decision. The court has never offered any reason on the record which we have been able to discover for refusing to release these funds from its control. We can speculate the rationale for requiring these limited partnership assets to be maintained in trust was to ensure money to pay the sanction would be available. The tenor of the second sentence of the district court's April 30, 1993 order leads to this speculation. However, our speculation remains just that. We have no informed basis for evaluating the propriety of the district court's action because in the end we are left guessing as to the court's purpose. We remand this issue to the district court to reevaluate its rationale for not releasing these funds based on the changed landscape of this opinion and explain its reasoning in detail.

VI.

Finally, the defendants argue the $402,527.98 supersedeas bond they filed to appeal the district court's sanction order supersedes the earlier $50,000 bond the court ordered on March 17, 1987. The defendants assert the second bond adequately protects Mr. Olcott's interests rendering the first bond unnecessary. We agree.

Originally, in a minute order of March 17, 1987, in conjunction with its original sanction against the defendants, the district court ordered them to post a $50,000 bond. The bond was posted on June 8, 1987. Subsequently, after the district court's final April 30, 1993 sanction order, on September 30, 1993, the defendants posted a supersedeas bond in the amount of $402,527.98, the total amount of the sanction.

The defendants filed their supersedeas bond pursuant to Fed.R.Civ.P. 62(d) to stay the district court's judgment against them pending appeal to this court. The purpose of requiring a supersedeas bond pending appeal "is to secure the judgment throughout the appeal process against the possibility of the judgment debtor's insolvency." *Grubb v. FDIC,* 833 F.2d 222, 226 (10th Cir.1987); *Miami Int'l Realty Co. v. Paynter,* 807 F.2d 871, 873 (10th Cir.1986). Typically, the amount of the bond matches the full amount of the judgment. *Id.; Texaco, Inc. v. Pennzoil Co.,* 784 F.2d 1133, 1155 (2d Cir.1986), *rev'd on other grounds,* 481 U.S. 1, 107 S.Ct. 1519, 95 L.Ed.2d 1 (1987). We have recognized, "[d]istrict courts, however, have inherent discretionary authority in setting supersedeas bonds." *Miami Int'l,* 807 F.2d at 873. Accordingly, in *Miami Int'l,* we affirmed the district court's decision not to require a supersedeas bond in the full amount of the judgment. *Id.* at 874. The instant case presents the opposite factual scenario. The combination of the two bonds results in insolvency protection for Mr. Olcott in excess of the amount of his judgment. We fail to understand the necessity of maintaining the original $50,000 bond after the defendants posted their second bond in the full amount of the judgment. Therefore, we reverse the district court's decision not to exonerate the $50,000 bond.

VII.

The district court's orders are **AFFIRMED IN PART, REVERSED IN PART**, and **REMANDED** for further proceedings consistent with this opinion.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff, vs. DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; LAYTON OIL COMPANY, a Kansas Corporation, WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH, DELAWARE FLOOD COMPANY 1977 EH, DELAWARE FLOOD COMPANY 1978 FH, DELAWARE FLOOD COMPANY 1979 LTD., limited partnerships under the laws of Oklahoma; and MICHAEL GALESI, Defendants.	)	Case No. 83-C-179-E

ORDER

(Docketed Feb. 5, 1998)

Now before the Court is the Motion for Summary Judgment (Docket #915) of the Defendants, Delaware Flood Company, an Oklahoma Limited Partnership, Delaware Flood Company 1976-DH, Delaware Flood Company 1977-EH, Delaware Flood Company 1978-FH,

Delaware Flood company, 1979 Ltd and Michael Galesi and the Motion for Summary Judgment (Docket #929) of the Defendants Layton Oil Company and William Douglas Layton.

Defendants request summary judgment on plaintiff's remaining state claims on three grounds: 1) Plaintiff, as a limited partner does not have standing to sue on behalf of the partnership; 2) the tort claims are barred on statute of limitations grounds; and 3) acceptance of the default judgment constitutes an election of remedy.

The Court rejects defendants' first argument. Plaintiff is not seeking damages on behalf of the partnership, or bringing "proceedings by a partnership," but rather seeks damages on his own behalf based on the investments he made in the limited partnerships. The Court finds that the authority cited by defendants for this proposition is not applicable to the specific facts of this case.

Next, in an apparent attempt to "whittle down" what will be tried in this case, and leave only the default judgment to defend, defendants attempt to defeat the state tort claims of plaintiff with statute of limitations and election of remedies arguments. With respect to the statute of limitations argument, Bernard Olcott filed this suit on July 7, 1982 regarding investments in the 1976, 1977, 1978, and 1979 programs. The suit was transferred to Oklahoma on February 18, 1983. With respect to torts, the statute of limitations under New Jersey law is 6 years, and under Oklahoma law is 2 years. Both parties agree that the transferee court must utilize the choice of law rules of the transferor court.

Thus New Jersey law applies to determine which statute of limitations to use. Under New Jersey law, the "interest based" test is used in determining the applicable statute of limitations period. *Computer Associates Intern Inc. V. Altri, Inc.*, 22 F.3d 32 (2d Cir. 1994).

Plaintiff argues that because both plaintiff and the "sole real party in interest" defendant are New Jersey Citizens, New Jersey's statute of limitations must be applied. In advancing this argument, plaintiff, relying on *Pine v. Ely Lilly and Co.*, 201 N.J. Super. 186 (App. Div. 1985) asserts that it is "strong public policy of New Jersey to promote the interests of its domiciliaries, and to provide a forum through which they can be compensated." The Court notes that there are defendants in this lawsuit other than New Jersey resident Galesi. Moreover, in considering all of the factors that resulted in the transfer of this case to this forum, the Court concludes that the "interest based" test dictates that Oklahoma law should apply. The limited partnerships were formed under Oklahoma law, the acts of alleged mismanagement and negligence occurred in Oklahoma, and the oil properties located are primarily in Oklahoma.

Thus, a two year statute of limitations runs from the time that the tortious or fraudulent acts were or could have been discovered. Based on the Court's previous ruling, that the statute of limitations began to run when plaintiff "knew he made a bad investment" in 1980, the statute of limitations bars the tort claims.

The primary issue raised by the motions for summary judgment is whether Plaintiff is entitled to pursue his state law claims and receive the benefit of the $1.9

million dollar [sic] default judgment he has previously been awarded. Plaintiff has stated both at the preliminary pretrial conference and at previous status conferences, that he wishes to accept the $1.9 million dollar [sic] default judgment, but that he wishes also to be able to put on the evidence for his fraud case as well. Plaintiff concedes that the damages are the same, but argues that proving the fraud cased [sic] is necessary because he may incur problems proving his case if the default judgment is ultimately reversed. This is not sufficient reason to allow Plaintiff to put on evidence to prove a fraud claim, when plaintiff already has received a judgment in his favor entitling him to the same damages. In the interest of efficiency and judicial economy, the trial of this matter is limited to the issues encompassed by the default judgment previously awarded.

Defendants' motions for summary judgment (Docket #'s 915 and 929) are granted in part and denied in part.

IT IS SO ORDERED THIS 3rd DAY OF ~~JANUARY~~ FEBRUARY, 1998.

/s/ James O. Ellison
JAMES O. ELLISON,
SENIOR JUDGE
UNITED STATES DISTRICT
COURT

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff, v. DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; LAYTON OIL COMPANY, a Kansas corporation, WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH, DELAWARE FLOOD COMPANY 1977, EH, DELAWARE FLOOD COMPANY 1978 FH, DELAWARE FLOOD COMPANY 1979 LTD., limited partnerships under the laws of Oklahoma; and Michael Galesi, Defendants.	No. 83-C-179-E

PRE-TRIAL ORDER

(Filed Aug. 9, 2000)

On this 9th day of ~~February~~ August, 2000 pursuant to Orders previously entered by this Court, the Court hereby enters the following Pre-trial Order.

I

A. STATEMENT OF THE CASE*

This is an action arising out of the solicitation, sale and operation of oil tax shelter limited partnership units purchased by Plaintiff Bernard Olcott, a limited partner, from the relevant Defendants in 1976, 1977, 1978 and 1979. In March 1986, Mr. Olcott filed motion to compel the Defendants to render an accounting of all partnership assets and income. The Defendants consented to give Mr. Olcott such an accounting. This Court ultimately found that three accountings submitted by the Defendants did not comply with the Court's accounting orders, and that such non-compliance was willful and in bad faith. As a result, this Court ruled on February 8, 1990 that:

1) "Plaintiff is entitled to a judgment against the Defendants, jointly and severally, for his investment of $1.9 million dollars [sic] less any portion of those funds which Defendants can establish were utilized for legitimate purposes under the terms and provisions of the limited partnership agreements. There will be a trial at which the burden will be upon the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties";[1] and

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* Defendants object to the Court reading the Statement of the Case to the jury for the reasons stated in Defendants' motion in limine previously filed.

[1] Defendants object to this determination. Plaintiff objects to the court's formula for determining the set-off. See Plaintiff's Rule 60(b)

(Continued on following page)

2) "Defendants still must comply with the accounting orders of this Court, and correct the deficiencies as found by the Court's expert,"[2]

This case was ultimately dismissed on statute of limitations grounds with sanctions imposed on the Defendants. The parties thereafter appealed to the United States Court of Appeals for the Tenth Circuit.

This action is back before the Court pursuant to the Tenth Circuit decision rendered February 26, 1996, in which the District Court's orders were affirmed in part; reversed in part and remanded for further proceedings. *Olcott v. Delaware Flood Co.*, 76 F.3d 1538, 1560 (10th Cir. 1996). The Tenth Circuit Court of Appeals noted in pertinent part:

> . . . Mr. Olcott sought an . . . accounting for the purpose of discovery. The central question posed

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Motion for Relief therefrom and this Court's Order denying same. See also Plaintiff's March 31, 1999 Renewed And Supplemental Motion For Hearing And Determination Of Plaintiff's Third Renewed Motion: (1) For Sanctions For The Defendants' Noncompliance With Discovery Orders And Their Failures To Purge Themselves Of Earlier Failures To Comply; (2) For The Suppression Of Defendants' Answers And Entry Of Final Default Judgment Against All Defendants Jointly And Severally; (3) To Vacate The February 8, 1990 Stay Of The Fee Award Process; And (4) To Adopt And Reduce To Judgment The March 30, 1989 Award Recommendation Of Magistrate Judge Jeffrey S. Wolfe. Said motion was denied in part and taken under advisement in part pending the conclusion of trial by order dated September 29, 1999.

[2] See September 26, 1990 report of Charles H. Ostrander, CPA, and Plaintiff's March 20, 1990 Application for Hearing and Determination on Plaintiff's 3rd renewed motion for Sanctions, etc. See also footnote 1, above. The Plaintiff contends that this Court has improperly allowed Defendants to ignore this obligation.

> by . . . [the] . . . lawsuit was what happened to the money he invested. His allegation of fraud centered on the defendants' alleged improper allocation of his money either to activities *ultra vires* to the limited partnership agreements or the defendants' improper commingling of partnership assets. Thus, an accounting was necessary for Mr. Olcott to prove fraud. Further . . . Mr. Olcott unsuccessfully attempted to employ more traditional discovery options. He turned to an accounting after it became increasingly clear depositions interrogatories, document requests, and requests for admissions would not provide the necessary answers . . .

Upon remand, May 5, 1997, this Court entered an Order, among other things, in which the court granted Defendants' motion for summary judgment on the securities act claim regarding the 1979 investment and granted Plaintiff's motion reinstating and retaining pendent jurisdiction over Plaintiff's remaining claims.

By order dated February 4, 1998, the Court granted in part, and denied in part, Defendants' motions for summary judgment. The Court ruled that the Oklahoma two-year statute of limitations in 12 O.S. 95 barred Plaintiff's tort claims and further ordered that, in light of Plaintiff's willingness to accept the $1.9 million default judgment award[3], there is "not sufficient reason to allow Plaintiff to put on evidence to prove a fraud claim when Plaintiff already has received a judgment in his favor entitling him to the same damages." The Court further held that "in the

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[3] The Plaintiff has never accepted the Court's criteria for establishing a set-off. See discussion below.

interest of efficiency and judicial economy the trial of this matter is limited to the issues encompassed by the default judgment previously awarded" by the February 8, 1990 Order. Hence, Plaintiff's claims for common law fraud, breach of contract, rescission, restitution negligence, mismanagement, malfeasance, misfeasance, partnership waste, breach of fiduciary duties and interference with business and investment objectives, were dismissed. Other claims and requests for relief were denied, as well.

By order dated September 29, 1999 this Court denied Defendants' motions for summary judgment; denied Plaintiff's renewed motion for the entry of a final default judgment and other relief; took Plaintiff's other sanction requests under advisement to be considered after trial; and took Defendants' motion *in limine* under advisement to be considered at the time of pre-trial conference.

This case is presently set for jury trial on March 20, 2000 at 9:30 a.m.

B. DEFINITIONS

1. "Olcott" refers to Bernard Olcott.
2. "DFC" refers to Delaware Flood Company, which is registered as an Oklahoma limited partnership.
3. "LOC" refers to Layton Oil Company, a Delaware corporation.
4. "D. Layton" refers to William Douglas Layton.
5. "1976 D-H" refers to Delaware Flood Company 1976-DH Program Ltd., an Oklahoma limited partnership.
6. "1977 E-H" refers to Delaware Flood Company 1977-EH Program Ltd., an Oklahoma limited partnership.

7. "1978 F-H" refers to Delaware Flood Company 1978-FH Program Ltd., an Oklahoma limited partnership.

8. "1979 LTD." refers to Delaware Flood Company 1979 Program Ltd., an Oklahoma limited partnership.

9. "The Subject Limited Partnerships" refers to 1976 D-H, 1977 E-H, 1978 F-H and 1979 Ltd. collectively.

10. "Galesi" refers to M. Michael Galesi.

11. "S. Layton" refers to Stephen Layton.

C. PARTIES

1. Plaintiff Olcott and Defendant Galesi are both residents and citizens of the State of New Jersey (for purposes of this action);

2. William Douglas Layton, is a resident and citizen of the State of Kansas;

3. Layton Oil Company ("LOC"), was a corporation organized in the State of Delaware with filed Articles of Domestication in the State of Oklahoma;

4. 1976 D-H, 1977 E-H, 1978 F-H and 1979 Ltd. are Oklahoma Limited Partnerships;

5. DFC is an Oklahoma Limited Partnership.

II

JURISDICTION

1. Jurisdiction was originally predicated upon 28 USCA § 1331 and federal securities act claims, all which have been dismissed.

2. There is no diversity of citizenship.

3. Jurisdiction is predicated upon the May 5, 1997 Order of the Hon. James O. Ellison, U.S.D.J., wherein this Court ruled that this Court would retain jurisdiction over Plaintiff's pendant state claims.

4. Defendants contend the Court lacks subject matter jurisdiction over the pendant state court claims of the Amended Complaint and object.

5. Defendants contend that there is a question of law as to whether Defendant Galesi is a properly pended party.

6. Plaintiff contends, among other things, that Defendant Galesi has controlled the defense of this matter, has actively and affirmatively participated herein (inclusive of consenting to the entry of accounting orders and obtaining a continuance of trial in March 1986), and is such a real party (Defendant) in interest so as to require his participation in the hearing and resolution of all pendant claims in this proceeding.

III

FACTS ADMITTED OR REQUIRING NO PROOF

A. FINDINGS OF COURT

The following facts have previously been found by the Court in its Order of February 8, 1990, and require no additional proof at the set-off trial. (Pursuant to a prior agreement of the parties, the Court's Findings have been slightly modified to more accurately reflect the facts). All of the parties (for different reasons) object to the scope of the trial and framing of the issues by the Court; nevertheless the facts and factual issues are set forth below for the

purpose of being in conformance with said order, with such objections preserved.

1. Plaintiff and Galesi are both residents and citizens of the State of New Jersey.

2. D. Layton is a resident and citizen of the State of Kansas.

3. LOC was organized in the State of Delaware and has filed Articles of Domestication in the State of Oklahoma.[4]

4. Equinox was the operator of the oil leases of the Limited Partnerships from January 1984 until 1990. Galesi owns all of the stock in Equinox.

5. The investments made by Plaintiff in the limited partnership interest were:

   a. DFC 1976, $350,000.00;

   b. DFC 1977, $500,000.00;

   c. DFC 1978; $550,000.00;

   d. DFC 1979; $500,000.00;

6. LOC was the turnkey drilling contractor for the Limited Partnership leases.

7. L & G, a non-party,[5] is a general partnership formed in 1977 whose present partners are

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[4] Its present corporate status is to be confirmed.

[5] Plaintiff previously unsuccessfully moved to have L & G and Equinox joined as party Defendants. Magistrate Jeffrey L. Wolfe previously recommended that Finoco be joined (which recommendation

(Continued on following page)

Galesi (85%) and Steve Layton (15%). The majority[6] of the properties contributed to the programs were assigned to DFC by L & G.

8. At all times relevant to this trial, DFC acted as the general partner of the limited partnership programs, and the operation of the limited partnerships was delegated by DFC to LOC.

9. LOC went out of business in December 1983 and assigned all of its assets to Defendant Galesi in 1984.[7]

10. Galesi originally solicited Plaintiff's four limited partnership investments.[8]

B. STIPULATED FACTS

The following facts are admitted and require no proof. The parties also agree to incorporate herein the stipulations of fact in the February 21, 1986 Pretrial Order (1-31) (with the understanding that the word "present" means February 19, 1996) and the Prehearing Order of February 17, 1989 (1-21). The stipulations in the injunction proceedings entered into on September 16, 1988 are *not* incorporated herein based upon the Defendants' assertion that

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was not followed). On March 15, 1991 Plaintiff filed a motion to add said three parties, which motion was denied

[6] Defendants contend that less than a majority of the leases were transferred by L & G.

[7] Plaintiff contends that Defendant Galesi was at all times a *de facto* general partner, notwithstanding the designation "Limited".

[8] Defendants dispute that Defendant Galesi solicited each investment.

such stipulations were made for the limited purpose of those ancillary proceedings. The Plaintiff objects to the Defendants' non-inclusion of said stipulations and believes that same were subsequently adopted as No. 20 in the February 17, 1989 pre-hearing order relating to the sufficiency of the April 15, 1988 accounting and that the same are relevant and binding.

1. DFC was formed as an Oklahoma limited partnership.[9]
2. D. Layton is a resident and citizen of the State of Kansas.
3. DFC-1976 is an Oklahoma limited partnership.
4. DFC-1977 is an Oklahoma limited partnership.
5. DFC-1978 is an Oklahoma limited partnership.
6. DFC-1979 is an Oklahoma limited partnership.
7. The Court has *in personam* jurisdiction over each of the parties to this action.
8. Plaintiff paid $350,000.00 for his limited partnership interest in DFC 1976, in 1976, by check made payable to that limited partnership.
9. Plaintiff paid $500,000.00 for his limited partnership interest in DFC 1977, in 1977,

[9] Its present status is to be confirmed.

by check made payable to that limited partnership.

10. Plaintiff paid $550,000.00 for his limited partnership interest in DFC 1978, in 1978, by check of Bernard Olcott made payable to that limited partnership.

11. Plaintiff paid $500,000.00 for his limited partnership interest in DFC 1979, in 1979, by check made payable to that limited partnership.

12. Michael Galesi was designated as a Limited Partner in DFC until 1984.[10]

13. Mr. Olcott executed all four partnership agreements. Yet all of the limited partnership agreements were not executed by all of the partners; and at least one of the partners failed to make a capital contribution.

14. Several limited partners, including Mr. Olcott, have claimed to have never received certain operating agreements, turnkey drilling contracts, lease schedules and program requirements which should have been attached. (The parties hereto will attempt to ascertain whether or not operating agreements, turnkey drilling contracts, lease schedules and program requirements were attached to these agreements.)

15. Each partnership entered into a "fixed cost" turnkey drilling contract with LOC, as

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[10] Plaintiff contends that from at least 1976 to present, Defendant Galesi was a *de facto* general partner and controlling person of DFC.

contractor, to perform all drilling and intangible development work. The limited partners' cash contributions, inclusive of Mr. Olcott's contributions, were as follows:

PARTNERSHIP	TOTAL CONTRIBUTIONS	MR. OLCOTT'S CONTRIBUTIONS
1976 D-H	$850,000.00	$350,000.00
1977 E-H	$900,000.00	$550,000.00
1978 F-H	$2,100,000.00	$500,000.00
1979 Ltd.	$2,525,000.00	$500,000.00

Mr. Olcott's contributions totaled $1,900,000.00.

16. The four (4) limited partnership agreements required the Defendants to utilize Mr. Olcott's $1,900,000.00, and the total limited partner contributions of $6,375,000.00, solely for the performance of the drilling, testing and completion of certain specified oil and injection wells on the lands owned by each partnership at a fixed cost equal to the total limited partner contributions for each partnership; such amount to include all labor, equipment, tools and supplies required for the drilling and all intangible development work on that partnership's leases.

17. The four (4) aforestated subject limited partnerships were formed to develop and operate oil wells on to waterflood leases in the following properties:

    (a) Wayside-Havana Field, Montgomery County, Kansas;

    (b) Woody Field, Nowata County, Oklahoma; and

(c) Certain locations in Lafayette, Nevada and Quachita Counties, Arkansas

18. Olcott, is a limited partner in the four (4) limited partnerships. DFC, an Oklahoma limited partnership, is named General Partner in each of the partnerships in which Olcott and the other limited partners invested.

19. Before he entered into each of the partnerships, Olcott had actual knowledge that LOC would act as the turnkey contractor.

20. The four (4) limited partnership agreements contain similar terms. By way of example, 1979 Ltd. contains the following language:

ARTICLE II

BUSINESS

2.1 The business of the Partnership shall be confined to the exploration, drilling, development, operation and production of oil, gas and other minerals from the oil and gas leasehold interests described in Exhibit A hereto (the "Properties").

* * *

2.4 Each party recognizes that the oil and gas business is highly speculative and the General Partner makes no quaranty [sic] or representation to the Limited Partners as to the possibility or probability of gain nor against loss from the conduct of the Partnership's business.

ARTICLE III

CONDUCT OF OPERATIONS

The general Partner agrees to use its best efforts to conduct a drilling, testing, development and production program on the Properties. The General Partner shall select the drilling contractor and service companies, which may include any partners or affiliates of the General Partner.

ARTICLE IV

GENERAL PARTNERS

4.1 Delaware Flood Co. shall be the sole General Partner.

21. The General Partner was required under the agreements to contribute properties (leases) having a total value of $2,200,000.00

22. The Defendants contend that the "Turnkey" drilling contracts adopted by the partnerships contain virtually identical terms. By way of example, the Defendants contend that the 1979 Ltd. Drilling Contract contains the following language:

DRILLING CONTRACT

THAT IT IS AGREED by the parties that Contractor Layton, for and on behalf of the Operator, shall drill and develop for oil and gas, on the properties described in Exhibit A, and in connection therewith shall perform all work hereinafter specified, for the consideration and on the terms and conditions hereinafter set forth as follows:

1. Depth and Commencement Date. On or before the 30 day of December, 1979, Contractor shall commence the actual drilling and development work and thereafter Contractor shall prosecute the development work with all due diligence as described in attached Exhibit B.

2. Duties of Contractor. Contractor shall perform all work, furnish all labor, equipment, tools, supplies, required for the drilling and all intangible development work described in attached Exhibit B.

* * *

11. Contractor's Compensation. The Contractor shall perform all of the work called from in Exhibit B on the Exhibit A leases attached hereto for a fixed turnkey price of $2,525,000.00 allocated amongst the prospects as indicated in Exhibit B attached hereto, which price shall be payable irrespective of the actual costs of performing such work and if the costs exceed such price no additional amount will be payable to Contractor. All risk of loss or mechanical problems of hole shall be that of Contractor and in any such case, Contractor shall fish, remedy or, if necessary drill another hole at no additional charge. Contractor shall hold Operator harmless from all liabilities for injury or damage to the person or property of third parties arising from Contractor performance hereunder. In order to assure availability and continued use of Contractor's rigs, personnel and equipment necessary for the performance of the work hereunder, Contractor requires that said fixed turnkey price shall be paid (and Operator accordingly shall pay

the same to Contractor) within December 25, 1979, days after the execution hereof.

23. The Defendants contend that the above referenced exhibits to each Drilling Contract set forth the properties to be developed and the work to be performed for each program.

24. The Defendants contend that the properties upon which the injection and oil wells were to be drilled and that the work that was to be performed for each of the partnerships is listed on Exhibit "A" hereto.

IV

FACTS NOT ADMITTED, NOT CONTESTED[11]

NONE

V

REMAINING CONTENTIONS OF THE PARTIES

Plaintiff's Contentions

1. This Court has ruled on February 8, 1990 that there will be a 'set-off' trial at which the burden will be upon the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties.

[11] Plaintiff contends that each of the accountings filed by the Defendants contain facts and figures which constitute admissions, some of which Plaintiff intends to rely.

2. In light of the Defendants' continued willful failure to account, and ongoing (post February 8, 1990) failure to make any real effort to comply with this Court's further provision:

> "Defendants still must comply with the accounting orders of this Court, and correct the deficiencies as found by the Court's expert,"[12]

the Plaintiff respectfully contends that the Defendants should be barred from offering *any* evidence to prove what they did with the Plaintiff's $1.9 million dollars [sic] in contributions; and requests guidance from the Court as to *what proofs* this Court will allow the Defendants to offer.

3. Plaintiff objects to Defendants' use of the accountings for any purpose.

4. Plaintiff contends that the Defendants are required to show what the Defendants actually did with Plaintiff's money.

5. This Court, in its order of September 29, 1999 denying Defendant's motion for summary judgment, has again rejected the Defendants':

> " . . . rather circular and conclusory argument (which) appears to be an additional attempt to avoid accounting for the use of funds as has been required by this Court and was, in fact a

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[12] See September 26, 1990 report of Charles H. Ostrander, CPA, and Plaintiff's March 20, 1990 Application for Hearing and Determination on Plaintiff's 3rd renewed motion for Sanctions, etc. See Plaintiff's March 31, 1999 Renewed and Supplemental motion for Hearing and Determination of Plaintiffs 3rd Renewal Motion for Sanctions, etc.

> requirement of the contract (noting that) the clear purpose of the Court's order granting the default judgment was to force Defendants to account for the use made of the turnkey drilling monies contributed by the limited partners, and if unable to do so, repay Olcott his investment. Therefore, to argue that the monies were used to pay the turnkey drilling contractor is of no help whatsoever to the analysis and defeats the purpose and intent behind the default judgment."

6. Utilizing the same reasoning, this Court denied Defendants any set-off for the return of investment received to date by Mr. Olcott.

7. At at least two conferences this Court has indicated that the Defendants' will be limited to proofs as to what they did with Mr. Olcott monies.

8. Nevertheless, the Plaintiff respectfully contends that this Court's formula (for lack of a better term) as to quantification of Defendants' set-off is an exercise in futility, and cannot be sustained on appeal, inasmuch as the same in and of itself does not reasonably relate to any of Mr. Olcott's claims.

9. By way of example, the Defendants not only failed to account for what was done with the turnkey contract monies; they also failed to account for the value of the leasehold interests (and other capital contributions) that the general partner obligated itself to contribute; they failed to account for partnership income; they failed to account for leasehold interests and equipment known to have been sold off; and for funds known to be improperly transferred to the Defendants or to third parties for the benefit of one or more of the Defendants.

Thus, were the Defendants to somehow demonstrate that they legitimately applied Mr. Olcott's contributions, they would be required to pay Mr. Olcott nothing, while 'getting away' with not paying him anything for his share of the partnerships' income and assets known to be improperly converted for non-partnership purposes.

10. Furthermore, the issue is clouded by the fact that the alleged turnkey contracts between inter-related Defendant entities having the same management and office did not specify the depth or locations of the wells; dates by which the development work was to be completed, and in at least the 1979 Program, the number of wells to be drilled. The contracts were found by the IRS to *not* constitute *bona fide* arms' length transactions.

11. Similarly, since it is anticipated that pre-judgment interest would have to be added back by the Court, any formula which fails to take into consideration Mr. Olcott's actual net return on investment may well not be sustainable on appeal.

12. Although Mr. Olcott would be willing to accept a final default judgment for the amount of his investment plus pre-judgment interest less his actual return on investment, he has *not* consented to forego his breach of contract and fraud claims for a default judgment less some number which in and of itself does not reasonably relate to anything – and which may not be sustainable on appeal.

DEFENDANTS' CONTENTIONS

1. In their November 10, 1998 Motion, Defendants assert that the application of the burden placed on Defendants will require the Court to perform a two-stage

analysis. In stage one, the Court will be required to interpret and construe the parties' agreements, including both the limited partnership agreements and turnkey drilling contracts, to determine from the language used, the subject matter of the transactions and the relations of the parties, the purposes or objectives for which Mr. Olcott's money could be used. Stage one presents a question exclusively for the Court and as described below, the parties' agreements are very specific as to the purposes Mr. Olcott's money could be used.

2. In stage two of the analysis, once the Court identifies by construing the parties' agreements, the *legitimate purposes* to which Mr. Olcott's money could be put, the determination will have to be made as to what portion of Mr. Olcott's contributions were put to those *purposes*. Defendants submit that, under the terms of the parties' agreements and tax laws which the agreements were structured to incorporate, Mr. Olcott's cash contributions could only be utilized to pay the turnkey drilling contractor for specified "fixed cost turnkey" drilling and intangible development work.

3. This concept is made manifest when the parties' agreements are examined. For example, first, as to the uses of a limited partner's money, such as Mr. Olcott, the Agreements provide that the limited partners' accounts "shall be charged" for delay rentals, intangible drilling and development costs and other costs which are deductible under federal tax law. Second, as to the drilling of the wells for which the limited partners' money was used, the turnkey drilling contracts provide that the drilling be conducted under a turnkey contract for a "fixed-cost" price. Third, the Turnkey Drilling Contract provides that the Contractor, in consideration for the cash payment from the

limited partners, such as Mr. Olcott, shall drill and develop for oil and gas on the properties described on Exhibit "A", and perform all work, furnish all labor, equipment, tools, supplies, required for the drilling and intangible development work described in Exhibit "B".

4. Moreover, the limited partners agreed that the legitimate use of their cash contributions was prepayment of the turnkey drilling contracts. The consideration to be received by the limited partners for their cash contributions was the performance by the drilling contractor of its contractual obligations under the turnkey drilling contract. This performance was considered to be the legitimate purpose called for under the operative agreements, i.e., contract performance demonstrates the legitimate utilization of the limited partners' cash contributions.

5. Mr. Olcott ignores addressing the remaining controversy in the case which is: What, if any, set-off Defendants can prove reducing the $1.9 million default judgment against the Defendants awarded Mr. Olcott by the Court in the form of a recissionary [sic] return of his investment. In the February 8, 1990 Order, the Court has shifted the burden of proof onto the Defendants *"to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties."* (February 8, 1990 Order) (Emphasis added).

6. The Defendants submit that the facts will establish: (i) the turnkey drilling contractor, Defendant Layton Oil Co., performed its obligations under the turnkey drilling contracts by drilling the wells required to be drilled in the contracts; and (ii) each turnkey drilling contract price was in keeping with similar charges by

other parties conducting fixed-cost drilling operations in the area, including the calculation of a reasonable anticipated profit and risk allowance.

7. Because the record will establish that the turnkey drilling contractor performed and the prices charged were reasonable, as required by the parties' agreements and which were the purposes for which Mr. Olcott's money was contributed, Mr. Olcott's contributions were used in conformity with the parties' agreements. Mr. Olcott received that which he bargained for, and Mr. Olcott is entitled to no recovery whatsoever. Therefore, judgment should be entered for the Defendants and against Mr. Olcott.

VI

ISSUE OF FACT

1. Whether, and if so, in what amount have the Defendants proven that they have utilized Mr. Olcott's contributions for each partnership for drilling and intangible development costs, the only legitimate purposes under the terms and provisions of that limited partnership's agreement.

VII

WITNESSES

A. Defendants' Witness [sic]

This Court has previously ruled that inasmuch as the Defendants have the burden of proof on the set-off issue, that the Defendants will go first.

1. See list attached as Exhibit "B".

2. The Plaintiff objects to the proffered testimony of Michael Galesi, Charles Underwood, Bernard Olcott (other than the amount of funds contributed), Stephen Perry, Greg Copeland, Don Smith, Gordon Romine, Brice Bogle, Dale Layton, Doug Layton, Robert Edwards and W. C. Morris.

B. Plaintiff's Witnesses

1. The Plaintiffs cannot determine his witnesses until the proofs that the Defendants will be allowed to offer is ruled upon.

2. Plaintiff reserves the right to call all of Defendants' witnesses; all witnesses listed on Exhibit "C" hereto, and any other witnesses.

VIII

EXHIBITS AND OBJECTIONS

The Plaintiffs and Defendants will exchange exhibits listed below on or before March 10, 2000 and any other exhibits Plaintiff or Defendants intend to offer at trial.

Defendants' Exhibits

1. See Exhibit "D" hereto.

2. The Plaintiff leaves the Defendants to their proof as to the authenticity of the 1979 partnership agreement, and as to the authenticity of all schedules to all agreements, inclusive of the operating agreements, turnkey drilling contracts and schedules of leases.

3. The Plaintiff objects to the use of after-the-fact reports, correspondence and agreements, and to use of the volumes of the April 15, 1988 accounting; unspecified charts, composite exhibits, copies of checks of payments to Mr. Olcott, and exhibits relating to alleged tax benefits.

B. Plaintiff's Exhibits

1. The Plaintiff cannot determine his exhibits until the proofs that Defendants will be allowed to offer is ruled upon.

2. The Plaintiff reserves the right to utilize all exhibits listed on Exhibit "E" hereto, and any other exhibits.

3. Exhibits utilized at depositions and video taped deposition of Jim Spears, CPA in this matter and the related matter of *Brand v. Galesi*.

IX

ISSUES OF LAW

1. See Plaintiff's Remaining Contentions.

2. The quantum of evidence by which the Defendants must prove any amount of set-off. Given their failure to account for what they did with Mr. Olcott's monies, the Plaintiff respectfully submits that the level of proof should be nothing less than by 'clear and convincing' evidence.

3. Whether Mr. Olcott's contributions, and other limited partner's contributions are to be treated as if the

same could solely be used for payment of all intangible drilling and development costs necessary for the turnkey[13] drilling, testing, cleaning, equipping or completing, recompleting, reworking, deepening, plugging and abandoning, and the preparation of wells for the production of oil and gas from the partnerships' properties.

4. Whether the court's February 8, 1990 Order requires the Defendants to trace each actual dollar of Plaintiff's contribution to vendors, labor and all other ultimate recipients in order to determine how much, if any, of the actual cash contributed by the limited partners was directly utilized for payment of turnkey drilling intangible and development costs.

5. Defendants' motion *in limine*, addressing the relevance and alleged lack of probative value of evidence relating to the accounting, pre-trial discovery disputes and other collateral matters.

6. Plaintiff's entitlement to recover sanctions (some of which have already been recommended by the Magistrate); prejudgment interest, counsel fees, expert fees, accounting fees, costs and taxed costs.

7. By the February 8, 1990, Order, the Court has entered a non-final default judgment in favor of Plaintiff and against the Defendants, jointly and severally, for $1.9 million *less any portion of those funds which Defendants can establish were utilized for legitimate purposes under the terms and provisions of the Limited Partnership Agreements.* The February 8, 1990 Order further states

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[13] as opposed to maintenance and remedial IDC work.

that there will be a trial at which the burden will be upon the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the term of the agreements of the parties.

8. Whether under the parties' agreements Mr. Olcott's contributions, and other limited partners' contributions, were to be used for payment of all intangible drilling and development costs incident to or necessary for the turnkey drilling, testing, cleaning, equipping or completing, recompleting, reworking, deepening, plugging and abandoning, and the preparation of wells for the production of oil and gas from the properties.

9. See Defendants' Addendum (Exhibit "F" hereto) wherein Defendants list what they contend are additional issues of law. The Plaintiff contends that such alleged issues are largely redundant and largely irrelevant in light of this Court's February 8, 1990, September 29, 1999 and other rulings which have limited the scope of the set-off trial.

X

POSSIBILITY OF SETTLEMENT

Plaintiff's counsel commenced settlement discussions with M. Michael Galesi which are to be continued. Settlement appears unlikely.

XI

ESTIMATED LENGTH OF TRIAL

Cannot be determined until evidentiary issues are made.

XII

THIS PRE-TRIAL ORDER SHALL SUPERSEDE THE PLEADINGS AND GOVERN THE SET-OFF TRIAL, UNLESS DEPARTURE HEREFROM IS PERMITTED BY THE COURT IN THE INTEREST OF JUSTICE

XIII

THIS MATTER IS TO BE TRIED BEFORE A JURY

The Court's Findings of Fact and Conclusions of Law, dated February 8, 1990 are incorporated herein by reference and attached hereto as "Exhibit G".

DATED this 9th day of ~~January~~ August, 2000.

/s/ James O. Ellison
JAMES O. ELLISON
UNITED STATES
DISTRICT JUDGE

APPROVED AS TO FORM AND SUBSTANCE: (All Objections Preserved)

For the Plaintiff:

THE FEINSILVER LAW GROUP, P.C.

By: _____
David Feinsilver

TIPS & GIBSON
Co-Counsel for Plaintiff

By: _____
Theodore P. Gibson
(OBA #3353)

For Defendants:

Layton Oil Co. and William D. Layton

By: _____
Paul D. Oakleaf

For Defendants:

Delaware Flood Company, Delaware Flood Company 1976 DH, Delaware Flood Company 1977 EH, Delaware Flood Company 1978 FH, Delaware Flood Company 1979 Ltd. and Michael Galesi

Boone, Smith, Davis, Hurt & Dickman

By: _____
Frederick N. Schneider, III
-and-
William C. Kellough

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

BERNARD OLCOTT, Plaintiff-Appellee, v. DELAWARE FLOOD COMPANY, et al., Defendants-Appellants,	Nos. 01-5119 and 02-5021

ORDER

Filed June 9, 2003

Before **TACHA**, Chief Judge, **BALDOCK**, and **MURPHY**, Circuit Judges.

Appellants' petition for rehearing is denied by the panel that rendered the decision.

The suggestion for rehearing en banc was transmitted to all of the judges of the court who are in regular active service as required by Fed. R. App. P. 35. No member of the panel and no judge in regular active service on the court requested that the court be polled on rehearing en banc so the suggestion for rehearing en banc is also denied.

Entered for the Court
PATRICK FISHER, Clerk of Court

by: /s/ Opal A. Carter
Deputy Clerk

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

BERNARD OLCOTT, Plaintiff, v. DELAWARE FLOOOD [sic] COMPANY, a limited partnership under the laws of Oklahoma, LAYTON OIL COMPANY, a Kansas corporation; WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH DELAWARE FLOOD COMPANY 1977 EH DELAWARE FLOOD COMPANY 1978 FH DELAWARE FLOOD COMPANY 1979 Ltd, limited partnerships under the laws of Oklahoma, and MICHAEL GALESI, Defendants.	)	No. 83-C-179-E

REPORTER'S TRANSCRIPT OF PROCEEDINGS
HAD ON AUGUST 29, 2000
NONJURY TRIAL
VOLUME I
(Filed Sep. 25, 2000)
BEFORE THE HONORABLE JAMES O. ELLISON,
SENIOR JUDGE

* * *

[5] management and does not know what the defendants did with his money.

THE COURT: Mr. Feinsilver, that is correct. The Court had ordered the accounting. The Court entered its sanction for the refusal and failure of the defendant to account. This trial is set for the purpose of completing that accounting. In other words, there is a $1.9 million judgment against the defendant. This trial is or the purpose of allowing the defendant to produce, if he can, the accounting in substance that had previously been required of him. That's what this trial is about. If he cannot satisfy those issues and if he is not entitled to credits, then the judgment will stand as entered, and that's what we're going to try here. That's the purpose of this trial.

MR. FEINSILVER: If I may, our Honor, I do wish to place on the record, I believe it was in 1987, Your Honor made a ruling from the bench that one way or another Mr. Olcott would either get the informational source to which he was entitled or he would have a default judgment, and what he has today is no informational source. Your Honor has taken away his fraud claims for judicial economy, Your Honor has taken away his contract claims, which would be benefit-of-the-bargain damages for purposes of judicial economy, Mr. Olcott has lost his entitlement to punitive damages under the fraud claim, and he has lost his entitlement to a contract claim,

* * *

[94] outside and make a telephone call.

THE COURT: Mr. Gibson can do that.

MR. FEINSILVER: Okay.

THE COURT: And we will proceed with Mr. Perry. Let's complete the testimony of Mr. Perry. The Court will reserve any action to be taken in this matter until I've heard from Mr. Ostrander, and then we will decide the course of action.

Mr. Perry, come forward and take the stand.

I will say that any objections, any discussion on objections will be made at side bar.

MR. FEINSILVER: Excuse me, Your Honor. May I just look up Mr. Ostrander's telephone number to give to Mr. Gibson?

THE COURT: I think Mr. Gibson is totally competent for looking up Mr. Ostrander's telephone number. I have full confidence in him.

MR. GIBSON: Thank you, Your Honor.

THE COURT: You may proceed.

STEPHEN M. PERRY

called as a witness on behalf of the defendants, having previously been duly sworn, testified further as follows:

DIRECT EXAMINATION (Continued)

BY MR. BURTON:

Q. Mr. Perry, before we left yesterday we were getting into the '77 E-H program. Do you recall that, sir?

[95] A. Yes, sir.

Q. Mr. Perry, where were the leases located with respect to the '77 E-H program?

A. The leases were located, the Havana properties, Wayside, Kansas, the Buena Vista Buckrange in Ouachita County, Arkansas and the Nacatoch leases in Ouachita County, Arkansas.

Q. And how many producing wells were drilled in the '77 E-H program with respect to the leases in Kansas, sir?

A. The total wells drilled –

MR. FEINSILVER: Excuse me, Your Honor, can we see what he's reading from? And I do have an objection, Your Honor, to the witness reading from documents, answers –

MR. BURTON: Your Honor, may we approach the bench if he's going to –

THE COURT: You may, you may, you may.

(Whereupon, counsel approached the bench, and the following proceedings were had out of the hearing of open court.)

MR. BURTON: Your Honor, we are ready to proceed in an expedited fashion this morning to get in the record what this gentleman knows with respect to how many wells we drilled in regard to these programs. Last night he looked at the maps, looked at the exhibits in this case, and is prepared to testify in that regard, and he has his notes in front of him. It's no secret what these notes were. They were produced and [96] copied in open court yesterday. This morning I handed to Mr. Feinsilver an additional note that I'm going to put in the record that – where he wrote down these numbers that he's getting ready to testify. He's aware of that. And I'm –

THE COURT: The only problem is that he's entitled to see –

MR. BURTON: That's correct. Which he does have.

MR. FEINSILVER: The problem that I have, Your Honor, is this matter has already been to the Tenth Circuit Court of Appeals twice and is undoubtedly going to go there a third time, and what I'm concerned about is the record. Your Honor –

THE COURT: You may approach and see what he's testifying from.

MR. FEINSILVER: I may have a solution, though, because my objections are going to be so cumbersome, Your Honor, and I see what he's reading from, but the record doesn't see that. What I respectfully –

THE COURT: Can you hear me? I said you can approach him, or you may deliver to Mr. Feinsilver what is on the bench. You have a right as a litigant to see what he has in front of him. Counsel assures me that it is what has been previously delivered to you, but you may have it delivered and look at it.

I am going to establish a time limitation in this [97] case. I think that what we will do at this point –

MR. SEYMOUR: Your Honor –

THE COURT: – because listening to this –

MR. SEYMOUR: Your Honor should know that he has already been delivered these documents. What's going on here in terms of dragging it out and delay is he – it is apparently his view that this man cannot testify about

numbers, and so on, unless he sits there and has 4,000 numbers in his head. Your Honor knows what that's all about.

THE COURT: He can refresh his recall from any reasonable source.

MR. SEYMOUR: But the time limit is going to – all these objections will eat into our time.

THE COURT: No. I have a solution to that.

MR. FEINSILVER: Your Honor, my next motion was going to be pursuant to Rule 403, if not Rule 402. And if Your Honor is inclined to hear this type of testimony –

THE COURT: We have a stipulation in the pretrial order in regard to the wells. It is there. I will hear the testimony of this man. You can have delivered to you what he has in front of him and then let's move it along. This is ridiculous, absolutely ridiculous.

MR. FEINSILVER: Well, what I was going to suggest, Your Honor, is that they simply put their proffer on the record. I have no intention of putting operational people on [98] as witnesses. Then he has his record what his testimony would be, and I'll just have a few questions for cross. But to do this under the guise of this being his direct testimony, I really don't think it appropriate, and it is time-consuming for me to make the necessary objections.

THE COURT: You have made your objection. You will be delivered the information and we'll move on.

MR. BURTON: Your Honor, my point was going to be that he already has the information. The information has already been delivered to him.

THE COURT: He hasn't physically viewed what is in front of the witness now.

MR. BURTON: I understand.

THE COURT: He doesn't trust that what he received earlier is the same, so he has a right to do that. You may do so.

MR. FEINSILVER: Well, then let the record reflect that I have a continuing objection, and then I won't – to him reading from documents –

THE COURT: You object to the witness testifying at all; is that it?

MR. FEINSILVER: I've already done that. And under Rule 403 I think all it does is waste time. I believe he can just simply make a proffer that his testimony would be –

THE COURT: Mr. Feinsilver, you can't tell them how [99] to try their case.

Give him what is in front of the witness.

MR. FEINSILVER: Well, then –

THE COURT: We don't need to discuss it any further, Mr. Feinsilver.

(Whereupon, counsel returned to their respective places, and the following proceedings were had in the hearing of open court.)

THE COURT: Mr. Burton, if you would get what the witness has in front of him and deliver it to Mr. Feinsilver.

MR. BURTON: Thank you, Your Honor.

May I approach the witness, Your Honor?

THE COURT: You may.

Q. (By Mr. Burton) Sir, how many producing wells were drilled in the '77 E-H program with respect to the leases in Kansas?

A. We drilled 29 wells.

Q. How do you know that, sir?

A. This is the program that was started after I was moved to the Independence, Kansas office. I was in the field daily. The drilling superintendent was a personal friend of mine. He was pushing the rigs that drilled these wells. I was doing the night cores on a number of these wells and attending the day cores. I was there when the casing was run and cemented on most of these wells, and my name is on most of the [100] completion forms as to do with the logging as a witness. I was there when many of these wells were logged. I was also there when many of these wells were perforated and fractured for production and perforated on the injection wells.

Q. Sir, how many injection wells were drilled in the '77 E-H program with respect to the leases in Kansas?

A. Thirty-four.

Q. Sir, would your answer be the same as you just testified with respect to how you know that?

A. Yes, sir.

Q. How many old holes were plugged in the '76 D-H program with respect to the leases in Kansas, sir?

A. We plugged 50 old holes.

Q. And, sir, again, is the reason you know that those 50 holes were plugged the same as your answer to the previous questions?

A. Yes, sir. Other than the rig worked – the right that plugged the wells worked directly for me, and everything else would be the same.

Q. Sir, in addition to drilling producing wells, drilling injection wells and plugging old holes, what other work was done on the '77 E-H program with respect to the leases in Kansas?

A. The roustabout crew that laid the low-pressure flow lines, the high-pressure injection lines and built the tank [101] batteries and saltwater disposal systems, worked directly for me. I should say they worked for the senior production foreman, who worked directly for me.

Q. Sir, I'm referring to the pretrial order in this case at Exhibit A, page 3, which references Exhibit B to the drilling contract for these leases in Kansas on this program, and in that Exhibit B to the drilling contract it says that there were to be 35 new producing wells drilled. You testified that there were 29 drilled. Sir, is there a reason why there weren't the 35 wells drilled?

A. If you look at in particular the Clubine lease, I believe our engineering staff had that planned for more producing wells than are there. If you look at the Diver,

the Diver property, there were more wells, they felt there would be more wells there than we were able to drill. So we came up short on producers, but there was – it was not necessary to drill any additional producers.

Q. And indeed, sir, the proposed development program was phrased in terms of the word "approximate" wells; isn't that correct?

A. That's correct, sir.

Q. And sir, does the fact that those additional wells were not drilled some way impact in your opinion on the performance of that program?

MR. FEINSILVER: Objection, Your Honor.

[102] (Whereupon counsel approached the bench and the following proceedings were had out of the hearing of open court.)

MR. FEINSILVER: Objection, Your Honor. Pursuant to Rule 403, I object. This is a whole area that invites extensive cross-examination, perhaps a need to have some additional testimony. It's not an issue, Your Honor. It's not –I can make a 402 objection. It's simply not relevant to these proceedings. The plaintiff himself has had various claims that he wished to make that Your Honor precluded on the grounds of judicial economy.

THE COURT: I take it you're into these issues of performance –

MR. SEYMOUR: The point, Your Honor, of this testimony is – (To the reporter:) Can you hear?

The point of this testimony is that the suggestion has been that – let's back up. This entire case has had as its

overarching issue that the defendants in this case hid money, hid transactions, stole Mr. Olcott blind.

Now, yes, those are tort issues that are no longer present. But the question is, did these people do bad things? And that informs at least two things. One, did they do it in general, which I agree is essentially irrelevant. But it informs all of the accounting issues, and if there is a deficiency anywhere, what is it? What impact did it have on [103] Mr. Olcott?

There is no person on the face of the planet who knows better what this company did for Mr. Olcott than this man who was out there in the field helping to cause it to happen, and when he testifies that this company was performing properly – and indeed he can – and where some of this is going, he can testify that this company did drilling work for things that had nothing to do with these programs and that they performed the work in exactly the same way, spent the same kind of money, took the same kind of care.

So that – that provides a backdrop so that if there is any problem in the accounting, without it Your Honor thinks, oh gee, there is some document that's missing here, these people must be bad people. When we know what went on in the field, then we have a background and we have Your Honor's ability to determine whether there should be any credits.

THE COURT: You should be assured, Mr. Feinsilver, that this degree of civility has the effect – the Court simply is the fact finder. When I address findings of fact and my conclusions of law, I'm only going to be addressing these relevant issues that are before the Court according to the pretrial order, according to the Court's

prior orders. There is much that may come in during a bench trial that might concern you, but it will not concern the Court. That isn't my task here, and we can spend a lot of time at the bench now [104] arguing about those issues and resolving them. But a look at this issue explains why they didn't do it. That may have absolutely no bearing at all on the findings and conclusions in this case.

MR. FEINSILVER: If I may. Your Honor, there were no less than 15 full days of testimony of all witnesses that each side wanted to produce. There were extensive proposed findings of fact and conclusions of law submitted by each party. There are cumulatively well over a hundred exhibits, and Your Honor has already made findings of fact and conclusions of law on February 8, 1990 that were attacked by the defendants on appeal and upheld by the Tenth Circuit Court of Appeals.

Whether or not they are good people or bad people and whether or not he has an explanation for the number of wells is wholly unrelated to this particular hearing. What I'm concerned about is I – Your Honor, I'm concerned that Your Honor may hear all this, irrelevant to this proceeding, testimony, which would require me to offer testimony to meet it, which I would rather not do. And if I did, quite frankly, I don't think our Honor would want to spend the time hearing the testimony. The Court is becoming impatient with these proceedings.

But what I'm concerned about is when Your Honor hears extraneous testimony, it might affect the Court and the Court might make a finding of fact with respect to it which might [105] have ramifications upon this proceeding. So given that, pursuant to Rule 402 and pursuant to

Rule 403 we're likely to consume much time needlessly. I would urge that it be excluded.

THE COURT: The question before the witness is why didn't you drill the other way. I would appear to the Court that that is not going to have any great relevance to the issue before us. However, it may develop as the basis for an accounting explanation. For that reason I won't exclude it. But I doubt if it's going to be very compelling to me as I address the issues before the Court. I'm going to overrule the objection.

MR. FEINSILVER: If I may, Your Honor. In light of Your Honor's comment, that just gives me an additional concern. Any explanation he might give is only relevant to the accounting. Your Honor has already made certain findings that they didn't account, they failed to account, and their not accounting was willful. Now, if Your Honor is going to consider whether –

THE COURT: I didn't say I was going to consider it; I said I would hear it. You're not hearing me. They can come in and talk about – challenge the moon shot, which might be remotely relevant, but it's not going to influence me in regard to my task of addressing findings.

The findings of fact previously issued by the Court [106] show the deficiencies in the accounting. What they have to do in this case is to establish that those deficiencies were met, and they are entitled also to any credit to which they are entitled. I have already expressed my view on the tax issues. We need to move this thing along.

MR. FEINSILVER: May I just make one statement? My most important factual witness as to what was done and what wasn't done and what was completed and

what wasn't completed, is now deceased. Jim T. Spears passed away on July 12, 1998 –

THE COURT: Don't you have his deposition?

MR. FEINSILVER: Not on this issue. He plaintiff doesn't depose his own individual, and I can't control what defendant has

THE COURT: I was thinking that he was deposed.

MR. FEINSILVER: Yes, he was deposed. But this man actually, for the plaintiff, walked those fields, inspected the equipment and inspected every single log and could have gone on for days as to what was completed, what wasn't completed, where discarded tubing was found, where things were disconnected, and he's not alive. And the reason that we don't have his testimony is because the defendants purposely asked for an accounting so that they could get a continuance of the trial. And Mr. Spears was there in 1986 and would have been my witness had we gone to trial.

[107] THE COURT: I am sensitive to your feeling that you're in somewhat strange territory, you are away from your home base. That's why I have tolerated delays we've had because I wanted to be eminently fair to you as I would be fair to your opponents, because you have continually delayed the process, continually by your actions delayed the process. That is not going to get us anywhere toward the conclusion of these issues and a resolution of your problem. I want to get this solved before Mr. Olcott passes away, and if we're going to delay it further – you've mentioned appeals will be taken. It's

highly doubtful we're going to be able to do that unless we have some sense of cooperation.

You're simply going to have to rely on the Court's ability to sift through all this information and decide whatever is relevant and appropriate to this proceeding and what isn't. That's all I'm telling you. Let's just try to keep the objections to a minimum or I'm going to have to reach a point where I say there will be no discussion or arguments on the objections and just rule and move on. And if we have these further delays, that's precisely what I'm going to do.

MR. SEYMOUR: Your Honor, may I make two points?

THE COURT: Yes.

MR. SEYMOUR: Mr. Feinsilver refers to possible appeals. We want a complete record in this case, and if there is and when there is an appeal, if there is one, it's not [108] going to have anything having to do with 15 or 40 or two or one day of prior anything. We're making a record here.

Far more important, what has continued prior to now and to this very moment is Mr. Feinsilver has ridden the horse, as we said yesterday, of you didn't account, you didn't account and you didn't account. We all know that. But we are here today to do something other than you didn't account. We're doing that, too.

In addition to you didn't account, the question is are you entitled to credits? Was there legitimate use of the money? And he is apparently desperately seeking to have Your Honor not focus on any of that. Your Honor has already indicated what the story is.

If there are deficiencies in the accounting, the issue still is are they entitled to any credits. That's all we're trying to do. But every time we have an objection it goes right to, well, gee, this isn't the accounting. That's what got this witness all upset yesterday. Oh my goodness, he says, I'm not talking about the accounting.

We've got other things to do here, we all know it, and we have these continuing objections. It's just what appears to be for the sole purpose of trying to hammer home the single, solitary point to divert the Court's attention. I know it isn't going to work, but it just wastes our time.

MR. FEINSILVER: If I may, I object to the ongoing [109] ad hominem attacks. I'm not desperately doing anything.

THE COURT: What the Court is going to do is overrule the objection. We'll find out why they didn't drill the wells, for whatever value, if any.

MR. FEINSILVER: Thank you, Your Honor.

(Whereupon, counsel returned to their respective places, and the following proceedings were had in the hearing of open court.)

THE COURT: Before we find out how many were drilled – I mean, the reason the additional wells weren't drilled – let's take a ten-minute break.

(RECESS)

THE COURT: Please be seated. Mr. Perry, please take the stand.

Mr. Burton, you may continue your examination.

MR. BURTON: Thank you, Your Honor.

Q. (By Mr. Burton) Mr. Perry?

A. Yes, sir.

Q. Do you recall my last question prior to our recess?

A. Yes, sir.

Q. Sir, could you please answer that question?

A. There were a number of wells or – we drilled 34 on the – we drilled 29, and we were to have drilled 35.

If you look on the McKemey lease, that is one producer we could not drill, and I remember it specifically [110] because it was –the well location fell in James Tremain's driveway, so we worked it out with him and we passed on that particular well.

Q. Sir, that has to do with one additional well that couldn't be drilled. What about the others?

A. As I said before, if you look at the Diver, the Diver did – the entire lease was not drilled up. It was not drilled up because the sand was – the sand's thickness was not there to drill additional wells. They would not have been good wells. They would have not produced.

If you look at the – if you look at the Clubine, Clubine the same way. The engineering staff felt that there would be more producing wells on that particular lease than we ended up drilling. The sand just pinched out.

Q. What about the Bragg and McKemey leases, sir?

A. As I said, we lost the one well on the Tremain due to it falling in his driveway, and if you look at the southern end of the Bragg, the quality of the sand there, it just wasn't there.

Q. So, sir, was there any effect on the programs because these additional wells weren't drilled?

A. No, sir.

Q. Sir, moving on to the Arkansas leases in the '77 E-H program, where were these leases located?

A. It was the Buena Vista Buckrange unit leases. They were [111] located in Ouachita County, Arkansas.

Q. And how many producing wells were logged, worked over and completed in the '77 E-H program with respect to the leases in the Buena Vista Buckrange unit?

A. We drilled 13 wells, sir. We actively logged or worked over and completed 13 wells.

Q. How many injection wells were logged, worked over and completed in the '77 E-H program with respect to the leases in the Buena Vista Buckrange unit, sir?

A. Seven wells.

Q. How many new producing wells were drilled in the '77 E-H program with respect to the leases in the Buena Vista Buckrange unit?

A. Three wells.

Q. How many new injection wells were drilled in the '77 E-H program with respect to the leases in the Buena Vista Buckrange unit?

A. Three wells.

Q. In addition to logging, working over and completing old wells and drilling new, producing and injection wells, what other work was done on the '77 E-H program with respect to the leases in the Buena Vista Buckrange unit, sir?

A. We laid the high-pressure flow lines. We did not have to lay all of the – we did not have to lay all of the low-pressure flow lines. We did refurbish and replace. We laid [112] all brand new high-pressure injection lines. We did not have to construct a brand new tank battery, but we did refurbish what was there and add a separator or two to the system.

Q. Sir, was all the development work which was contemplated in this program with respect to the Buena Vista Buckrange unit performed?

A. Yes, sir.

Q. How many producing wells were completed in the '77 E-H program with respect to the leases in the Nacatoch – is that how you pronounce that?

A. Nacatoch.

Q. Nacatoch?

A. Yes, sir. Five.

Q. And how many wells were worked over and completed in the '77 E-H program?

A. Four.

Q. And in addition to working over old wells and drilling new producing wells, what other work was done on

the '77 E-H program with respect to leases in the Nacatoch?

A. One thing I meant to bring up on the Buena Vista, and it applies to the Nacatoch also because these are stacked sands. You're on the same acreage, one is deeper than the other, but you're in a very silty sand situation. An additional expense there was the construction of the roads. The roads were in very, very poor condition, and when you construct roads in [113] sandy loam or sandy silt, your construction costs are much higher and that's one of the things they had to do here.

Q. With respect to these –

A. Both.

Q. Both these leases in Arkansas?

A. Yes, sir. In addition to that, on the Nacatoch lease, again, we did not have to build a brand new tank battery, and we did not. We refurbished what was there. They did not have WOG separators on site so we installed new WOG separators, and we refurbished the tank battery that was on site. We laid – we refurbished the flow lines again. We had to replace some of them completely with new low-pressure pipe. The injection wells, we did lay all brand new high-pressure steel line to the injection wells.

Q. Sir, was all the development work which was contemplated in this program with respect to these leases located in the Nacatoch performed?

A. Yes, sir.

Q. Sir, did you have an opportunity in this area in Arkansas to drill wells for projects that were not program wells?

A. Yes, sir.

Q. And, sir, did you treat those wells any different than the program wells that were drilled in Arkansas?

A. No, sir.

Q. You didn't cut corners with the program wells?

A. Oh, no sir.

Q. Sir, moving on to the '78 F-H program, where were the leases located with respect to the '78 F-H program?

A. In Kansas the leases were the Faull, the Morgan, the Wiley and the Watson.

Q. Okay. Sticking with the Kansas leases, how many producing wells were drilled in the '78 F-H program with respect to those leases in Kansas?

A. We drilled 35 producing wells.

Q. Sir, were there any lakes that were constructed in connection with those leases?

A. Yes, sir. We constructed two large lakes south of the Wiley project.

Q. And could you show the Court on the demonstrative exhibit where those lakes were located, please?

THE WITNESS: Judge, can you see this? Do I need to turn this?

THE COURT: If you turn it just a little. That will be fine.

A. This was the Wiley project.

THE COURT: He's going to need the mike.

MR. BURTON: May I approach the witness, Your Honor?

THE COURT: Yes.

A. This was the Wiley lease in the F-H program. We constructed two lakes to the south on two leases that were not [115] involved in the Wiley program.

Q. (By Mr. Burton) Did those lakes that were constructed, sir, specifically benefit the leases that were part of the F-H program that you've shown there on your map?

A. Yes, sir.

Q. When were those lakes built, sir?

A. Those lakes were built in about 1980.

Q. And sir, do you know how much it costs approximately to build those lakes?

A. I believe it was $100,000.

Q. And was that –

MR. FEINSILVER: Objection, Your Honor.

THE COURT: It will be sustained. This should be part of the records. If there is – in other words, if the strategy of the defendant is to establish an accounting and a matter of expenses, then it would have to have a better source than an approximation. I'll sustain the objection.

Q. (By Mr. Burton) Mr. Perry, do you have an independent personal recollection as to the specific cost of those lakes, sir?

A. I know personally –

MR. FEINSILVER: Objection, Your Honor.

THE COURT: The objection will be sustained.

Q. (By Mr. Burton) Sir, how many injection wells were drilled in the '78 F-H program with respect to the leases in [116] Kansas?

A. Forty-six.

Q. And how many old holes were plugged in the '78 F-H program with respect to the leases in Kansas?

A. Thirty-seven.

Q. And in addition to drilling production wells, drilling injection wells, and plugging old holes, what other work was done on the '78 F-H program with respect to these leases in Kansas, sir?

A. We laid brand new low-pressure flow lines to each producing well. We laid or installed new high-pressure steel injection lines to all of the injection wells. We constructed new tank batteries, and we constructed new saltwater injection plants for the flooding operation.

Q. Sir, with respect to the '78 F-H program and the leases in Kansas, was the development work which was contemplated completed?

A. Yes, sir.

Q. Sir, moving on to the Oklahoma leases in the '78 F-H program, what were those leases?

A. That was the Hunter lease and the Yirsa lease, the Hunter and the Yirsa lease.

Q. And how many producing wells were drilled in the '78 F-H program with respect to those leases in Oklahoma, sir?

A. Eleven.

[117] Q. And, sir, with respect to the Hunter lease, were there any wells that were converted?

A. Yes, sir. There – originally, when we decided to use three of the center injection wells as producing wells based on our first two core jobs, we really had very thick, good sand, so the decision was made to drill these three injection wells, big hole, set big casing, and produce them for approximately one year as producers. And that was done.

Q. Sir, could you just take a quick moment just to point out to the court with your pointer where this Hunter lease is located that you just testified to?

A. Yes. This is the Hunter lease in Nowata County, Oklahoma. This is the Yirsa lease that's part of the same – of the F-H program.

Q. And where, sir –

A. This is the Yirsa and this is the Hunter.

Q. And with respect to the Hunter lease, where were these wells that were converted that you just testified about, sir?

A. These three center wells were drilled, big hole and big casing was set so they could be used as production wells.

Q. And after they were used as production wells, sir, what happened?

A. After they were – we produced them about a year, and at that time we removed the pumping units, the tubing and the rods, and installed new tubing and packers, and the wells were [118] put on injection. We put – we started putting water in the wells.

Q. So what was the effect of what you just testified to, sir, on this program and those specific wells?

A. Well, we got an initial flush for about the first year, which enhanced the profitability of the property by producing these three injection wells, and we started putting water in them a year later and we started seeing an effect in a few months.

Q. How many injection wells were drilled in the '78 F-H program with respect to the Hunter and Yirsa leases in Oklahoma, sir?

A. We drilled 12.

Q. How many old holes were plugged in the '78 F-H program with respect to the Hunter and Yirsa leases in Oklahoma, sir?

A. We plugged 10 wells.

Q. In addition to drilling producing wells, drilling injection wells, and plugging old holes, what other work was done on the '78 F-H program with respect to the Hunter and Yirsa leases in Oklahoma, sir?

A. We laid the new low-pressure flow lines, we laid brand new steel high-pressure injection lines, we built a state-of-the-art injection plant on the east side of the Yirsa, which in it was two brand new KT 3350 Kerr pumps. I was very proud of that project. And we constructed the tank batteries and – [119] constructed the tank batteries.

Q. Sir, was all the development work which was contemplated by the drilling program with respect to these leases in Oklahoma, which were the Hunter and Yirsa lease, performed?

A. Yes, sir.

Q. Sir, moving on to the Arkansas leases that were part of the '78 F-H program, what were the leases that were part of the '78 F-H program in Arkansas?

A. The Ritchie Grocer, the Harold Knighton 1, 2 and 3, the Daniels 1, 2, 2X, 3, 4 and 5, the Dayton-Nix No. 1, the Dayton-Nix No. 2 saltwater disposal, the Dayton-Nix well No. 3, the Strange well No. 1, the Baker-Smith well No. 1, and the Cleveland-Nix well No. 1.

Q. Sir, how many producing wells were drilled in the '78 F-H program with respect to the leases in Arkansas?

A. There were 16 wells drilled.

Q. In addition to drilling these producing wells, what other work was done on the '78 F-H program with respect to the leases in Arkansas, sir?

A. We had five dry holes out of this list of wells, therefore there were just – we just built the tank batteries and laid the low-pressure flow lines and the disposal lines

on the wells that produced. I remember on a few of these we were able to refurbish the tank batteries that were there and add a different separation system, enhance it, and – on all but the [120] five dry holes, and that was all just – we would just take temporary tanks out there. We always took temporary equipment out and tested prior to building tank batteries and flow lines and things of that nature.

Q. Sir, was all the development work which was contemplated in the drilling program with respect to these leases in Arkansas performed?

A. Yes, sir.

Q. Sir, moving on to the '79 DFC program, where were the leases located with respect to this program?

A. In southeast Kansas, the Wayside field, Montgomery County, Kansas. The East Freeman, the West Freeman and the Abbie-Norris.

Q. Okay. Now, sticking with the Kansas leases that were part of the 1979 DFC program, sir, how many producing wells were drilled in the '79 program with respect to the leases in Kansas?

A. There were 26 producers drilled.

Q. Sir, how many injection wells were drilled in the '79 program with respect to the leases in Kansas?

A. Thirty-six injection wells.

Q. And how many old holes were plugged in the '79 program with respect to the leases in Kansas?

A. Twenty-five.

Q. In addition to drilling producing wells, drilling [121] injection wells and plugging old holes, what other work was done on the '79 program with respect to the leases in Kansas?

A. One project was a very expensive boring under a road where there were telephone lines, high-pressure gas line and a number of other flow lines between the East Freeman and the Abbie-Norris. In addition to that, we built a state-of-the-art injection plant. We set the tank batteries for each lease, we laid low-pressure steel flow lines and the steel high-pressure injection lines to the injection wells.

Q. Sir, in this area in Kansas you also did projects that were not program wells; correct?

A. That is correct.

Q. And, sir, did you treat those projects that were not program wells any different than the program wells?

A. No, sir.

Q. Sir, was all the development work which was contemplated by the drilling program with respect to the 1979 program and specifically in the Freeman leases in Kansas, was that development work completed?

A. Yes, sir.

Q. Sir, was all the development work which was contemplated by the drilling program with respect to the Abbie-Norris leases in Kansas completed?

A. Yes, sir.

Q. Sir, moving – were there leases in Oklahoma in the '79 [122] program?

A. Yes, sir, the Wilkinson lease.

Q. And how many producing wells were drilled in the '79 program with respect to the Wilkinson lease in Oklahoma?

A. We drilled six producers.

Q. And how many injection wells were drilled in the '79 program with respect to the Wilkinson lease in Oklahoma?

A. We drilled three.

Q. And how many old holes were plugged in the '79 program with respect to the Wilkinson lease in Oklahoma?

A. We plugged 10.

Q. Sir, in addition to drilling producing wells and drilling injection wells and plugging old holes, what other work was done on the '79 program with respect to the Wilkinson lease in Oklahoma?

A. We made an addition to the Hunter tank battery for the Wilkinson. We laid the low-pressure flow lines and high-pressure injection lines.

Q. Sir, was all the development work which was contemplated by the drilling program – that drilling program being the '79 program – performed with respect to the Wilkinson lease in Oklahoma?

A. Yes, sir.

Q. Sir, what were the leases in the '79 program that were located in Arkansas?

[123] A. It would be the L. Hix, the Coleman-Cargill, the Y Addition, the Kennedy, Ravencraft, Jones-Morrow, and the Ash.

Q. Sir, with respect to the Y Addition, was there more than just one or –

A. Yes, sir.

Q. And what was the number, in terms of more than one?

A. I believe there were nine wells drilled on the Y Addition.

Q. How many producing wells were drilled in the '79 program with respect to all of the leases in Arkansas, not just the Y Addition, sir?

A. There were 20 wells drilled.

Q. And in addition to drilling producing wells, what other work was done on the '79 program with respect to those leases that you've mentioned, sir, in Arkansas?

A. We built brand new tank batteries on some, we refurbished and updated some of the tank batteries, there were some new flow lines laid and some new high-pressure injection saltwater disposal lines, and on a number of those – not on a number, but on a few of those we did – had to redo the saltwater disposal plants.

Q. Sir, was all the development work which was contemplated by this drilling program performed with respect to the leases in Arkansas?

A. Yes, sir.

[124] Q. Sir, in connection with these programs that you've testified to, where did this equipment come from in terms of what was the type of equipment? Just generally speaking?

A. Well, you would purchase pumping units, tubing or rods, casing, tanks, pumps.

Q. And was this equipment new equipment? Used equipment?

A. Much of it was new, some of it was used.

Q. And why were you using equipment as opposed to new equipment, sir, when you did use used equipment?

A. Availability is always a problem. At this time some new equipment wasn't available in a timely fashion, some of it wasn't available for months.

Q. Why was that, sir?

A. Because of the price of oil and the activity in the Continental United States.

Q. So there were occasions when used equipment was essentially the only available alternative?

A. That is correct. And also, you – there were times when we could go and purchase used equipment. We always sent our mechanics to look at it, to tear into it, and what we could buy used equipment for in the shape it was in, many times it was as good as new equipment.

Q. What instances do you recall, sir, where any of the programs suffered losses or harm due to using used equipment as opposed to new equipment?

A. We had the normal, everyday problems with some of the wells where you purchase – and we always purchased 7,000-pound tested tubing, but we did have – there were a few times we had problems with the used tubing, holes coming in the tubing, possibly earlier than we would with a new string of tubing. But it wasn't – there were just very few cases.

Q. Well, were there any cases, sir, where the program was actually harmed due to using used equipment as opposed to new equipment?

[125] A. No, sir, you don't harm a producing well because the tubing gets a hole in it.

Q. Sir, do you recall Mr. Olcott ever planning trips to Independence, Kansas?

MR. FEINSILVER: Objection, Your Honor.

THE COURT: What is the purpose of this testimony?

MR. BURTON: Sir, may I approach?

THE COURT: Yes.

(Whereupon counsel approached the bench and the following proceedings were had out of the hearing of open court.)

MR. SEYMOUR: The purpose of this, Your Honor, is addressing the subject of Mr. Olcott's coming to Kansas to view accounting information and get records. This gentleman has a slightly different recall of the number of times that Mr. Olcott came to Kansas and engaged in those efforts than [126] Mr. Underwood, who

was directly involved in the accounting. In fact, Mr. Perry remembers a couple more times, I think, than Mr. Underwood does. Whichever it is, they both recall that he came.

This man knows what Mr. Olcott was doing, and this goes to the issue of Mr. Olcott being informed through himself and accountants and petroleum engineers of problems as they – he knew they existed and were ongoing – and that he got, he was given the records, anything he asked for. That goes to the issue.

THE COURT: Mr. Seymour, this goes back behind this court's order. This goes behind the order.

MR. SEYMOUR: I would respectfully submit that it doesn't from this standpoint: There are a number of records that are missing, and they are missing because they were either (a) tossed to in the normal and ordinary course of business, or (b) because of the flood, which we will have testimony about, and we will hear about that from Mr. –

THE COURT: I heard about that before.

MR. SEYMOUR: I understand, but that's not in this record.

THE COURT: It's in the record of this case, but not on the record in this proceeding.

MR. SEYMOUR: Right. And so to the extent that there aren't any records and that causes any problems with [127] the accounting, not only is that, if you will, a separate and independent, gee, you know, you can't do the impossible, but separately, this man when he came had access to every record that he desired to look at. They

have very carefully seen to it that he isn't here, and I suspect that that's primarily for this reason.

There were issues that were discussed between him and Mr. Galesi and between him and Mr. Underwood, and we will be presenting their testimony about that. Indeed we have some out of his own deposition where he knew exactly what the problems were. There wasn't anything hidden here. He knew about all of this stuff that went on, and we want Your Honor to know that it isn't just he says, you know, he says in his deposition, well, I knew about this and I knew about that. Well, how is it that he knew it? It's because he came to Kansas and he was here for days at a time and he spent virtually all of his time, as did his accountant and his petroleum engineer, with the accounting records of the company.

THE COURT: The problem the Court has is that these issues have been addressed to the court in these proceedings, and I know that you weren't present at that time, but those – all that testimony merged in the Court's order. I evaluated all the evidence at the time I wrote my order.

MR. SEYMOUR: Well, we're not – no, we're not [128] challenging Your Honor's order. The question now is the subject of (a) completing the accounting, and (b) are we entitled to any credits? And when Your Honor is weighing any deficiencies in the accounting, the availability of those records and that they were given to him and that he was physically present here is of enormous importance, we submit.

And it goes to this issue of – again, the suggestion is that this was just a bunch of thieves and bad guys who were hiding everything. He came, he was given access, he

was given whatever it was he wanted. We think that's very important for this record. Otherwise, all we have in this record is too limited.

THE COURT: Anything?

MR. FEINSILVER: Yes, Your Honor.

THE COURT: You speak softly, Mr. Feinsilver.

MR. FEINSILVER: Your Honor has already stricken Mr. Olcott's security for claims, finding that Mr. Olcott is already on inquiry notice. Now, whether these defendants were bad guys, good guys – what kind of information someone gave Mr. Olcott, didn't give Mr. Olcott, has nothing to do with the consent order to render the accounting or this particular sanction proceeding –

THE COURT: Mr. Seymour. I'm going to have to agree with that.

MR. SEYMOUR: Well, Your Honor, then I need to [129] know – borrow – our way of approaching this, what this trial is about. Your Honor has told us that this trial is about two things. Mr. Feinsilver says it's about one thing, and the issue here is, surely, are these people entitled to credits?

THE COURT: They're entitled to credits, but where does what Mr. Olcott may have seen go to that issue? The Court listened to all the testimony, and in my findings were the deficiencies in the accounting. What you need to do is to attempt to repair those deficiencies to the accounting. If there were monies disbursed to Mr. Olcott, a $600,000 issue, that is an issue that you're certainly entitled to pursue. The issue of $300,000 in escrow is also

an issue that you may pursue. If there is going to be a claim made –

MR. SEYMOUR: Let me make one last thing, if I may. The issue, Your Honor – let's assume that the accounting is deficient in one small area. I don't know what a good example is. But okay, you haven't got the records in this area. Well, that's one thing. The next issue is, what harm came to Mr. Olcott? I know that the best example is this business of they don't have records to show the original cost of the leases. Now, that is technically deficient from an accounting standpoint, but when Mr. Olcott comes in and says make it zero and they agree, that issue disappears.

Similarly, if there is any deficiency in the [130] accounting and Mr. Olcott has been there and has had the opportunity to look at records and did look at records, the issue is what adverse consequences flow from any particular deficiency in the accounting?

THE COURT: Let me refresh what happened here. Prior to trial, many, many moons ago, in order to avoid that trial date, your client, Mr. Olcott, came before the Court, entered into a stipulation to provide a specific type of accounting. The testimony of his counsel, his former counsel, was that Mr. Olcott, after he had made that commitment to this court, said there is no way I'm going to do that. I am not going to comply with that order. Now, the sanction had to do with that.

This evidence came in based upon that refusal and they had three shots at it. At the time he entered into that discovery order, he knew whether there had been a flood, he had known all the problems that he had. And this case

isn't about whether he's a bad guy or a good guy. I don't make that judgment. That isn't my task.

MR. SEYMOUR: Well, I think, Your Honor, everything Your Honor said is true, but there is another aspect of this accounting. He may have said that. Indeed Your Honor has found that he said that. Okay? Now, there were people out here who were doing the real work, all the work – he wasn't doing any of the work. There were people out here who, as [131] Your Honor will hear for the first time, in this trial, that was never said to them. They did what they could, they did what they thought they were supposed to, they did what Peat Marwick told them to do, indeed they did what their lawyers told them to do.

Now, that is a wholly separate issue from bad intent and bad statements. But when these people who are actually doing the work don's – Your Honor will see and will find, that they didn't have any of this bad intent, they were doing what they thought. And these are the same people who, when Mr. Olcott came to town, he would talk to them and he would ask them for records and they gave him the stuff. Some of these missing records he saw at the time.

THE COURT: These people and that evidence should have been presented previously. The Court sanctioned the defendant for that conduct.

MR. SEYMOUR: I agree that it should have. And it would sure have been a different case if I had been here.

THE COURT: But it was not done.

MR. SEYMOUR: But we're now at the trial. I mean, Your Honor has acted on that and has imposed the

sanction of default judgment subject to, has reversed the burden of proof, but that doesn't go to the issue of these people now being able to come in and show that they're entitled to credits. You have already taken action against them for what went on [132] before in this fashion.

THE COURT: The action is the $1.9 million judgment.

MR. SEYMOUR: All right.

THE COURT: If he has no evidence to show the credits against that judgment –

MR. SEYMOUR: We do.

THE COURT: – then we can walk away.

MR. SEYMOUR: And we do.

THE COURT: It's all over with. If you show credits, that's what you will be allowed to do.

MR. SEYMOUR: That's what we're here for.

THE COURT: I'm going to sustain the objection to this testimony. You might ask him this. Is Mr. Olcott going to be produced for your case?

MR. FEINSILVER: Mr. Seymour may not be aware of it, but there was at one time during discovery an application for Mr. Olcott's tax returns. In response – in partial response to that, Mr. Olcott's accountant gave a detailed affidavit setting forth the precise figures of what was received, what was not received. I don't know that there is any dispute on what Mr. Olcott received or didn't receive. There is probably a dispute as to the net amount, but I don't think – because it involved litigation and what

Mr. Olcott's litigation costs were – but I don't think that's the subject of plenary testimony of the accountant.

[133] THE COURT: I don't know that the testimony involves matters that were addressed by the Court and merged into the Court's order. If there were true credits received, Mr. Seymour, let's hear them.

MR. SEYMOUR: Okay, I will ask you this. As you consider it, Your Honor, Mr. – we had this discussion beforehand and I don't want to belabor it, but I think it's of enormous importance. The tort claims are gone.

THE COURT: They're gone.

MR. SEYMOUR: Intellectually, logically and legally the only kind of damages Mr. Olcott is entitled to now are rescissionary damages.

THE COURT: He has already gotten his damage in the form of a sanction –

MR. SEYMOUR: I understand that.

THE COURT: – The Court has entered.

MR. SEYMOUR: I understand that, but it only will be upheld and avoid the appeal he's concerned about. He has told Your Honor at the pretrial hearing, and indeed it's in the pretrial order, that it's rescissionary damages. So it goes to that, and he has to give back –

THE COURT: He misspoke.

MR. SEYMOUR: Well, if it isn't that, what is it?

MR. FEINSILVER: I did not – the record speaks for itself. I think we both have – Mr. Seymour and I, our [134] counsel, have our own characterization, but it's very

clear this was a sanction, and Your Honor has made clear that this is a sanction proceeding.

THE COURT: That's all that it is. And Mr. Seymour is at a disadvantage because he was not present during the entire history of this miserable experience.

MR. SEYMOUR: Well, in the pretrial order Mr. Feinsilver says – this is in his section – that he is concerned about this case being reversed unless the proper theory is used, and – whatever the words are, it's in the pretrial order – and we submit and just will carry on as it goes, but we submit that it has to be rescissionary damages, recognizing that it's a sanction, because with the tort stuff gone, he has to give back – in order to get damages, he has to give back what he got.

THE COURT: It's a very simple process –

MR. FEINSILVER: Just for the record, One, availability of documents was the –

THE COURT: The issues presented to the Court, there are issues of credibility and believability because we know about fires and we know about floods –

MR. FEINSILVER: I'm sorry. There were issues about withholding documents from Peat Marwick, their own accountants. This has nothing to do with –

THE COURT: I think we've reached an understanding. [135] I believe we've reached an understanding. We're in trial.

MR. SEYMOUR: At the risk of some humor, I once represented a gentleman who was sanctioned $5,000 by Judge Covey because he didn't produce documents at

the deposition because they had burned up in his car on the way.

THE COURT: I had a cattle case in this very courtroom before Judge Savage, and all I told him was that he had to have some reason for the disappearance of the cattle, I certainly wasn't going to – but as we left, all I inquired about was how did those cattle drown in the Arkansas River? That was early in my life, so I know that there are excuses and valid reasons and/or interests.

MR. FEINSILVER: If I may, Your Honor, just very briefly. I have done extensive Tenth Circuit research, and one of the key holdings that I recall is a holding that the tail goes with the hide.

THE COURT: I shouldn't even have raised the cattle issue.

MR. FEINSILVER: On the issue – my theory is very simple for this hearing. I believe Mr. Olcott is entitled to his money back plus prejudgment interest less net return on each –

THE COURT: That's fine. Let's not address this –

MR. FEINSILVER: Okay, thank you.

THE COURT: At this point, I think we're all agreed [136] with what we're trying.

MR. FEINSILVER: Thank you, Your Honor.

THE COURT: The objection is sustained.

(Whereupon, counsel returned to their respective places, and the following proceedings were had in the hearing of open court.)

MR. BURTON: No further questions, Your Honor.

THE COURT: Thank you very much. Mr. Feinsilver, you may cross-examine.

CROSS-EXAMINATION

BY MR. FEINSILVER:

Q. Sir, are you related through blood or marriage to any of the Layton family members?

A. Yes, sir.

Q. What is that relationship?

A. Doug Layton is my father-in-law. I married his daughter.

Q. What program was the Watson-Faull leas on?

A. I believe that was a '78 – let me look here –

Q. You need to look at –

A. That was a '78, I believe.

Q. Okay. Is it your testimony that the program was completed?

A. Yes sir.

Q. Do you know who Howard Alexander is?

A. Yes, sir, I do.

[137] Q. Who is Howard Alexander?

A. He is a banker.

Q. Do you know who Dale Layton is?

A. Yes, sir, I do.

Q. Who is Dale Layton?

A. He is deceased, and a former vice president of Layton Oil Company.

Q. Was he not also the brother of Doug Layton?

A. No, sir.

Q. What was the relationship?

A. They were cousins.

Q. Now, sir, I showed you a document that has been marked as F-1 in court proceedings on August 25, 1988, and also marked as Plaintiff's Exhibit 2 Ostrander –

MR. BURTON: Your Honor –

THE COURT: Have you exchanged these with your opponent? If not, you should do so.

MR. BURTON: Your Honor, we have never seen this exhibit. He never produced any exhibits. The sanction order is in effect in respect to that. I don't know what he's talking about.

MR. FEINSILVER: Your Honor –

MR. BURTON: I object.

MR. FEINSILVER: I intend to show him this document to see if it refreshes his recollection as to whether or not [138] the program was completed, which was an issue that I didn't know I had to meet, which is

something that I obtained this morning from files I haven't seen in many years, Your Honor.

THE COURT: You can place the document in front of him. If it refreshes his recall, then he may testify as to his recall, but he cannot read from the document nor can you read from the document, nor will it be accepted in evidence, in accordance with the Court's prior ruling.

MR. FEINSILVER: Yes, Your Honor, but there is one cumulative record, and –

MR. SEYMOUR: We would ask that this be a side bar if it's going to be a colloquy.

THE COURT: Right. But you may proceed in that way. You may place the document in front of him for the purpose of seeing if it refreshes his recall.

MR. BURTON: May I look at it, Your Honor, or a copy, please?

THE COURT: Yes.

MR. BURTON: Thank you, Your Honor.

MR. FEINSILVER: May I approach the witness?

THE COURT: Yes. Mr. Feinsilver, you may go to the podium and resume your questioning.

Q. (By Mr. Feinsilver) Sir, does F-1 from accounting sufficiency hearings, admitted into evidence on August 28, 1988, refresh your recollection as to whether or not that [139] program was completed?

A. I've never seen this letter before, sir.

Q. That's not the question, sir. Does that letter refresh your recollection as to whether or not the program was completed?

A. Sir, on February 1st, 1985, when this letter was written, I was –I had been transferred to Arkansas a year earlier. I was not working out of the Kansas office when this letter was written.

THE COURT: Your testimony is it does not refresh your recall; is that correct?

THE WITNESS: No, sir. I –

THE COURT: Very well. You may proceed.

Q. (By Mr. Feinsilver) Do you know what Mr. Dale Layton's position with the business was in 1985?

A. I believe he was – in 1985 he was an employee of Equinox Oil Company, and I believe he was a petroleum engineer.

MR. FEINSILVER: Your Honor, if I may, I have another document.

THE COURT: Is this for the purpose of refreshing recall?

MR. FEINSILVER: Solely, Your Honor. It was marked as F-2. It's a letter from Dale Layton to Michael Galesi dated July 2, 1985, and I am offering it solely – I mean, I just want to show it to the witness to see if this letter [140] refreshes his recollection.

THE COURT: You may do so.

MR. BURTON: Your Honor, I ask that –

A. Again, sir, in July of 1985 I was managing our Arkansas properties and our Louisiana properties.

MR. BURTON: Your Honor, I would object. Ask the witness, does this letter refresh your recollection? That is the question posed.

THE WITNESS: I'm sorry. No, it does not. I –

MR. FEINSILVER: That's all I have, Your Honor.

THE COURT: Very well. Thank you very much. Any additional questions of Mr. Perry?

MR. BURTON: No, Your Honor.

THE COURT: Thank you. And thank you, Mr. Perry. You may step down.

MR. FEINSILVER: If I may, Your Honor, I just would like to state for the record that I did maintain a continuing objection and that I've limited my cross-examination pursuant to Rule 403, in terms of what I understand to be relevant.

THE COURT: All right, very well. The record will reflect that that has been your objection.

You may call your next witness, Mr. Seymour.

MR. SEYMOUR: Mr. Bernard Olcott.

THE COURT: Mr. Bernard Olcott by?

MR. SEYMOUR: By deposition, Your Honor, taken on

* * *

[175] account since the sale date in 1990.

Q. Does any of this proceeds of any of the $952,000 relate to an exercise of a put by Mr. Olcott?

A. Yes, sir. The number we testified to earlier on Exhibit 35, the $271,152 number, was an amount received by Mr. Olcott as a result of his exercise of a put on the 1977 program.

Q. Now, are you aware, sir, that at a point in time in these proceedings that a claim was made by one or more defendants with regard to the amount of money that the Court has placed under escrow being subject to the payment of legal expenses?

MR. FEINSILVER: Objection, Your Honor. What does –

THE COURT: I'd like to understand what he's talking about. Overruled.

A. Yes.

Q. (By Mr. Seymour) Allright, sir, Are you also aware that at this point in time –

MR. SEYMOUR: And to the extent it is not in the record prior to now, we will make this as a representation to the Court, simultaneous with asking the question.

Q. (By Mr. Seymour) Are you aware, sir, that any claim of the defendants to any of that money that we're talking about in escrow has been waived?

A. Have the defendants waived their claim, is that what you asked?

* * *

[213] to you?

A. The information I got was that Mr. Olcott could not find his copy of the '77 return. He tried to obtain a copy from the Internal Revenue Service and they could not find it.

Q. Indeed, they said it had been destroyed?

A. Yes.

Q. And Mr. Olcott told you all of this?

A. No. No, this came through – I believe through Mr. Feinsilver to Mr. Kellough.

Q. Thank you.

So that we have a –

THE COURT: I'm trying to figure if that's second or thirdhand.

MR. SEYMOUR: I would say it is the admission of an agent somewhere near the Arkansas river.

THE COURT: Right.

MR. SEYMOUR: For purpose of being able to present argument and authorities to Your Honor in due course, I would like to ask the following question.

THE COURT: All right.

Q. (By Mr. Seymour) In your examination of Mr. Olcott's tax returns, did you determine the net tax savings to him as a result of his investment in these four programs?

A. Yes, I did.

Q. And what is that dollar amount?

[214] A. His original – the original returns that he filed each year generated a benefit to him in excess of $700,000.

Q. On records that dealt with costs prior to 1979, which we talked about on Exhibit 11, you may recall?

A. Yes.

Q. The records that were thrown out in the normal and ordinary course with regard to those costs, was that true for the '76, '77 and '78 programs?

A. '76 and '77 only. The '78 program, some of those records – and the Court has heard a lot of testimony about the documents that were destroyed by the flood in the basement – some of the '78 and '79 program documents were destroyed in that flood. But only the '76 and '77 documents were discarded in the ordinary course of business.

Q. Now, the company did it keep its books on a per-well basis with regard to the cost of drilling?

A. No, it did not.

Q. Tell me about that.

A. The accounting system that was in use prior to 1979 –

MR. FEINSILVER: Your Honor, I have to object. This is all part of the accounting sufficiency. It has nothing to do whatsoever with setoffs.

MR. SEYMOUR: Well, Your Honor, prior to now we have had complaints that testimony or documents don't deal with the accounting. Now that we're dealing with the accounting, the

* * *

[403] asked you about distributions that the general partners took which they shouldn't have that belonged to the limited partners?

A. Yes.

Q. Were those distributions ever repaid in full?

A. Yes, sir, upon termination of the partnership, full accounting was made for all credits, net credits to all the partners' capital accounts.

Q. All right, sir. Directing now your attention to the limited partnership agreement for 1979, where Mr. Feinsilver asked you the question about the paragraph which deals with the general partner not commingling the funds, sir?

A. Yes, sir.

Q. And does it say, sir, in that document that the funds are not to be commingled until they're used for partnership business, sir?

A. That's what it says.

Q. And as a payment of money to the drilling contractor partnership business?

A. Yes, sir.

Q. Now, had the money been set aside in a Delaware Flood Company account and never given to the drilling contractor, first of all, what would happen to the income tax deduction?

A. The deduction for the prepayment would undoubtedly been denied.

[404] Q. And if the drilling contractor hadn't received the money, would there have been any drilling?

A. No.

Q. Now, if the drilling contractor takes the money and sets it aside in a separate account, what is it that happens?

A. Well, if those funds are in any way considered to be a deposit, again, the deduction for the prepayment of the turnkey drilling costs would be denied.

Q. And was it your testimony, sir, that it isn't just setting aside in a separate account, it is anything that's done that gives that appearance?

A. That certainly would increase the risk of having the deduction denied, substantially increase the risk of having the deduction denied.

MR. SEYMOUR: That's all I have, Your Honor.

THE COURT: Anything further, Mr. Feinsilver?

MR. SEYMOUR: I may have one further, if I may, Your Honor. All right, sir. One other thing, if I may Your Honor.

Q. (By Mr. Seymour) As the result of Mr. Olcott receiving this $271,151.96 pursuant to the put, is that a

return of investment on his – investment in these programs?

MR. FEINSILVER: Your Honor, I'll object.

THE COURT: I'll allow him to answer. You may answer.

* * *

[409] liquidation.

Q. Would it be the other limited partners?

A. The limited and the general partner. I think some of that belongs to the general partner, as I recall.

MR. FEINSILVER: Excuse me, Your Honor. That's all I have.

THE COURT: May Mr. Underwood step down?

MR. SEYMOUR: Yes, Your Honor.

THE COURT: Thank you very much, Mr. Underwood.

THE WITNESS: Yes, sir.

THE COURT: Do you really feel like starting a new witness today.

MR. SEYMOUR: I do, Your Honor, has been – well, I won't say it.

THE COURT: Yes.

MR. SEYMOUR: I can finish Mr. Olcott.

THE COURT: Do you want to rethink that on – I would take it and read it this evening, if you want to give it to me.

MR. SEYMOUR: Oh, I cannot tell you how short it is.

THE COURT: Okay.

MR. SEYMOUR: We can wait until in the morning.

THE COURT: If it's short, we'll do it.

MR. SEYMOUR: It really is. Page 100 line eight:

Q. "Did you have an opportunity to see the partnership [410] agreement documents and operating agreement documents and turnkey drilling contract prior to investing your money in December of each year?"

THE COURT: I'm sorry. One other question. Do you have a copy that you can supply to the court reporter when you're through.

MR. SEYMOUR: Yes, Your Honor, it will have my markings of where we start and complete.

THE COURT: That's okay. It will be of benefit to her.

MR. SEYMOUR: Sure.

A. "It was a simultaneous acceptance."

Q. "I'm sorry?"

A. "It was acceptance to invest the amount of money set aside by my signature by me and an approval of the

turnkey contract and an approval of the partnership agreement and the certificate of partnership."

Q. "So those documents" –

MR. FEINSILVER: Excuse me, Your Honor –

THE COURT: I'm sorry, we cannot hear you.

MR. SEYMOUR: Your Honor, he wants the page and line number which I have given and as has happened at very crucial point that is made in this case by us, there has been an interruption. May I start over?

THE COURT: You may start from the beginning. Do [411] you have designations –

MR. FEINSILVER: No, Your Honor.

THE COURT: You have no designations.

MR. FEINSILVER: No.

MR. SEYMOUR: Page 100 line 8.

THE COURT: Have you provided him designations.

MR. SEYMOUR: I haven't provided him designations, Your Honor, no. We were – agreed to nothing and he was going to figure out what it was that he wanted to do subsequent.

MR. FEINSILVER: Your Honor, may I have a copy of what is given to the reporter when it's given to the reporter?

THE COURT: You may and you may examine it before it's provided. It's simply to help her in the transcript because attorneys tend to read rapidly when they're

reading from documents and it's difficult for a reporter to follow them. So as an aid to the transcript, I would require that the deposition be given to her.

MR. SEYMOUR: We'll be happy to supply him with page and line numbers, Your Honor.

THE COURT: Very good.

MR. FEINSILVER: Your Honor –

MR. SEYMOUR: Page 100.

MR. FEINSILVER: I'm requesting the same copy that is given to the reporter.

[412] MR. SEYMOUR: Apparently he doesn't have it, Your Honor. That should be his problem and not us to have to do it for him. Page 100 line 8.

THE COURT: Let me interrupt. You may review what is given to the reporter. Very well.

MR. SEYMOUR: Page 100 line 8:

Q. "Did you have an opportunity to see the partnership agreement documents and operating agreement documents and turnkey drilling contract prior to investing your money in December of each year?"

A. "It was a simultaneous acceptance."

Q. "I'm sorry?"

A. "It was acceptance. It was acceptance to invest the amount of money set aside by my signature by me and an approval of the turnkey contract and an approval of the partnership agreement and the certificate of partnership."

Q. "So those documents –"

A. "Simultaneous."

Q. " – were there at the time you signed your check, you signed the documents?"

A. "Yes."

MR. SEYMOUR: Page 112, line 7:

Q. "Each time you invested your money, was the motivation tax related, profit related or both?"

A. "Certainly both because it was very much investment [413] related. If I were only addressing the tax advantage, I didn't have to put up the cash."

MR. SEYMOUR: Page 127, line 18:

Q. "Have you executed any other amendments to this '76 partnership agreement?"

A. "There is one other amendment which changes. It's someplace in one of these files you'll see it. It changes capital. Paragraph 6.1 which in this document says, and he's quoting, 'Upon execution of this agreement, the general partner shall contribute without warranty of title the properties to the capital of the partnership for which the capital account of the general partner shall be credited in the amount of $800,000,' close quote."

"I objected to any figure of there being credited for anything except money that they put into the partnership. So they – we have in here an amendment, another amendment which reduces this figure of $800,000 to zero and you will find it if you look for it. Shall we proceed with this first amendment?"

Q. "Was the second amendment that you referred to reducing the contribution to zero, was that a written amendment?"

A. "Yes, signed by Mr. Layton."

Q. "And was it signed by you as well?"

A. "It was – it declared to me that it is zero. Well, you find it and you tell me what it is. I didn't have to agree to

* * *

[460] But we have two issues and if we had the accounting as required by the Court, it would answer the other issue. So I don't want to spend a lot of time dealing with anything other than the credits to which Mr. Galesi is entitled.

MR. FEINSILVER: If I can correct –

MR. SEYMOUR: May I, Your Honor, ask the question then, as I understand it though, our obligation is to show that we have provided an accounting in compliance with the Court's order.

THE COURT: That's one thing, that's one thing.

MR. SEYMOUR: That's one thing and we wish to do that. Do I understand Your Honor to be ruling that we have or haven't done that? I don't think I hear that.

THE COURT: No, no.

MR. SEYMOUR: All right.

THE COURT: I'm not saying that. I'm not saying that at all.

MR. SEYMOUR: Okay.

THE COURT: What I am saying is a perfect accounting should show all of the credits. I think your main chore here is to attempt to develop each and every credit that Mr. Galesi is entitled to because –

MR. SEYMOUR: I understand, but I also would like to be able to show the accounting because we think we can.

THE COURT: – because that's still out there. I'm [461] saying a perfect accounting does not remove any of the obligations of the sanction previously imposed. Doesn't change that except it meets the requirement to account.

MR. SEYMOUR: Yes, yes. Then we still –

THE COURT: The judgment would still stand –

MR. SEYMOUR: If we couldn't show credits.

THE COURT: If you couldn't show credits.

MR. SEYMOUR: Yes, sir.

THE COURT: Okay. Then we're on the same page.

MR. SEYMOUR: Right.

THE COURT: You may proceed.

MR. FEINSILVER: May I continue the objection that Your Honor said I could make before Your Honor left?

THE COURT: All right.

MR. FEINSILVER: It was just stated before Your Honor left that your order merely says the findings of the accountant, but if Your Honor looks, Your Honor, at paragraphs 42(a) through (j), commencing on page 16 of the February 8, 1990 order, Your Honor lists the deficiencies cited.

THE COURT: I think that's what I said, Mr. Feinsilver.

MR. FEINSILVER: I'm sorry, Your Honor.

THE COURT: All right. You may proceed.

Q. (By Mr. Seymour) I'll try and shorten this, Mr. Ostrander?

* * *

[469] That's all that's really important here, unless I say, after that's established and my order is entered, if I find that the accounting as demanded by the Court's order has not been met, then there would be that continuing obligation.

But I suspect that once we establish how much money or credits have been received, that that will probably disappear because I probably – at that point, will have lost great interest.

You may proceed.

MR. SEYMOUR: Thank you, Your Honor. And I shall turn to that very directly now.

Q. (By Mr. Seymour) Now, as far as credits are concerned, sir, would you agree that if all of the wells were drilled and if it cost Layton Oil Company a million nine to

drill those wells, that the Defendants should be given credit for legitimate use of the money for a million nine?

A. Assuming that we're talking about arm's length transactions and –

Q. Well, sir, a million nine is a million nine whether it's spent arm's length or side length, isn't it?

A. That's true.

Q. All right. Now, would you agree with me, sir, that the turnkey contractor under the drilling contracts that are – well, you've seen the drilling contracts that were used here, have you not?

* * *

[474] along and he asks the question and solicits the answer that it isn't arm's length and then I'm precluded from going into arm's length. We have some extremely critical testimony –

THE COURT: Well, the critical testimony is how much money did Mr. Olcott get and that's really all that we need to deal with.

MR. SEYMOUR: All right.

THE COURT: Unless I want to keep a sword over Mr. Galesi's neck on meeting the terms of the accounting and I assure you that I really don't, once we get this number established.

MR. SEYMOUR: Okay.

THE COURT: In that regard, let me ask this of Mr. Feinsilver: Is there a figure that you stipulate to, and I think you did yesterday when you referred to your

accountant's affidavit, is there a figure that you stipulate to that Mr. Olcott received?

MR. FEINSILVER: Yes, Your Honor.

THE COURT: All right. And what is that number?

MR. FEINSILVER: It's the six –

MR. SEYMOUR: 623.

MR. FEINSILVER: 623,000.

THE COURT: I'm sorry, six hundred –

MR. FEINSILVER: 623,161.

THE COURT: 623,161 and you stipulate that he [475] received that?

MR. FEINSTEIN: That's –

THE COURT: And they're entitled to credit –

MR. FEINSTEIN: I didn't say that. That's an issue for Your Honor to decide whether – but that's part of the sanction order but that is the number that we say he received and that's in Mr. Bato's affidavit from March 11, 1987, giving the exact breakdown of when those monies were received and in what amounts. And I asked Mr. Ostrander to total it and he came up with 623,161.

THE COURT: Very well. That's the number and I will accept it.

You may continue.

Q. (By Mr. Seymour) All right, sir. Have you read those pages?

A. Well, I'm trying to, yes. I'm sorry.

MR. SEYMOUR: I'm going to hit just a couple more accounting points, Your Honor, then I'm going to go right into the money.

MR. FEINSILVER: Your Honor, I though he was going to be given the whole transcript. I don't want him to have part of a colloquy.

MR. SEYMOUR: That's what cross is for or redirect is for, Your Honor.

THE COURT: Do you have the transcript, Mr.

* * *

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November 3, 1998

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Tulsa, Oklahoma 74103

Attention: Frederic N. Schneider, III, Esq.

RE: Supplemental Report
Delaware Flood Company Limited Partnerships
Turnkey Drilling Contracts for 1976, 1977, 1978 and 1979 Partnerships – All States

Gentlemen:

This supplemental report summarizes results of an investigation of limited partnerships developed and operated by Delaware Flood Company in Lafayette, Nevada and Ouachita Counties, Arkansas. Results of the original report dated June 23, 1998, regarding partnership leases in Kansas and Oklahoma, are incorporated into this report. Conclusions drawn as a result of both investigations are as follows:

1. The drilling contractor did fulfill its obligations under the four prepaid turnkey drilling contracts.

2. Prepaid turnkey drilling contract prices are in keeping with similar charges by other parties in the area during the 1976-1979 era.

A discussion immediately following this letter presents details of the investigation. Four exhibits have been prepared and these accompany the discussion. Reference is made to the index preceding this letter for a listing of items covered in the discussion and the exhibits.

GENERAL

Information utilized in this investigation was obtained from sources identified in the discussion. All information is assumed to be correct. No attempt has been made to verify title or ownership of any of the partnerships' interests nor were the leases inspected by a representative of this firm. This investigation has been conducted utilizing methods and procedures regularly used by petroleum engineers in investigations of this type and character.

* * *

contract sets forth the approximate number of producing and/or injection wells to be drilled and the approximate number of existing wells to be recompleted and/or plugged. This information is summarized on Exhibit IV. It is pointed out Exhibit IV was a part of the first report but has been revised to include information regarding proposed drilling for Arkansas as well as more complete information on drilling in Kansas and Oklahoma.

The Limited Partners' cash contributions were utilized to prepay the various turnkey drilling contracts as follows:

PARTNERSHIP	TURNKEY CONTRACT PRICES
1976 D-H Program Ltd.	$ 850,000
1977 E-H Program Ltd.	$ 2,000,000
1978 F-H Program Ltd.	$ 2,100,000
1979 Program Ltd.	$ 2,525,000
TOTAL	$ 7,475,000

COMPLIANCE WITH TURNKEY CONTRACTS

The first phase of this investigation involved determining whether Layton Oil Company had satisfied terms of the turnkey drilling contracts by performing the work required in those contracts, that is, by drilling, recompleting, and/or plugging of wells. Previously mentioned Exhibit IV compares the required drilling and intangible development work for each turnkey drilling contract with the actual drilling and intangible development work completed. It shows that Layton Oil Company not only performed the drilling and intangible development work as required, but completed more well work in each of the partnerships than specified in the contracts. This is shown on the following table with data extracted from Exhibit IV.

	Well Work*		
Partnership	Required	Performed	Excess
1976 D-H	88.0	108.0	20.0
1977 E-H	161.0	168.0	7.0
1978 F-H	127.0	178.0	51.0
1979	117.0	117.5	0.5
Total	493.0	571.5	78.5

*includes wells drained and completed, recompleted and/or plugged

It is pointed out information on Exhibit IV relating to Kansas and Oklahoma drilling does not agree, in all instances, with similar information on Exhibit IV in the original report. Numbers in the first report were based on incomplete information and these have been adjusted to agree with actual well counts. The correct well counts appear in Brice Bogle's affidavit dated August 12, 1998, which was subsequent to preparation and submittal of the original report.

Reference is made to Exhibit VI-A, which is a summary of oil sales from the Arkansas leases and partnerships from their formation through 1984 as determined by the firm of KPMG Peat Marwick (KPMG) in its accounting of the four partnerships. Sales volumes determined by KPMG compare favorably to those obtained from commercial sources and provide supplemental substantiation that the wells are drilled and/or recompleted. Exhibit VI in the original report presented similar information for Kansas and Oklahoma leases.

ANALYSIS OF TURNKEY DRILLING PRICES

Under the terms of a turnkey drilling contract, the drilling contractor agrees to drill a well or wells and perform certain work on a lease or project for a fixed price. That price will be paid to the contractor regardless of the problems the contractor encounters. The contractor guarantees the wells will be drilled and/or the work performed. If, for example, a well is lost for any reason, the contractor must drill a replacement well. Because there is substantial additional risk to the contractor, it is accepted that prices reflect a significant markup over normal drilling prices. The amount of the markup may actually vary with the area, depths being drilled and/or the familiarity the contractor has with the area in question. The Internal Revenue Service will accept a markup of 30 per cent as an intangible deduction. It is pointed out this is an arbitrary amount imposed by the Service, and courts have awarded deductions reflecting as much as a 93 per cent turnkey markup.

Analysis of the turnkey prices involved in this matter began with a review of prices prevailing in the 1976-1979

time frame. Investigation of these prices in Kansas and Oklahoma was discussed in the first report. Drilling prices prevailing in the South Arkansas area in the late 1970s – early 1980s were reviewed with Mr. Robert M. Reynolds of Shuler Drilling Company, Inc., El Dorado, Arkansas. Shuler Drilling has been active in the South Arkansas – North Louisiana area for about forty years. Mr. Reynolds has been with the company since the early 1970s. Shuler had actually drilled one or more of the wells included in this investigation. Shuler drills wells on both footage and turnkey contracts.

Additionally, pricing data, as reflected by schedules from vendors and invoices submitted for services and/or work performed, were reviewed.

This pricing information was compared to an estimate prepared by Layton for a well to be drilled to a total depth of 3,100 feet. Utilizing all of the pricing information (Layton's and others), estimated prices for drilling and/or recompletions in each of the three programs were prepared. These were then used to prepare Exhibit V that is a revision of Exhibit V in the original report. It has been expanded to include information regarding Kansas and Oklahoma wells from the original Exhibit V with well counts adjusted to reflect correct well counts as shown on Exhibit IV. It summarizes prices estimated by use as well as adjustment of those prices to reflect turnkey markup (percentage and amount). Pertinent data from Exhibit V is summarized as follows:

Partnership	Estimated Prices	Turnkey Markup Per Cent	Turnkey Markup Amount	Turnkey Contract Price
1976 D-H	$ 750,291	13.3	$ 99,709	$ 850,000
1977 E-H	1,700,374	17.6	299,626	2,000,000
1978 F-H	1,569,154	33.8	530,846	2,100,000
1979	1,470,935	71.7	1,054,065	2,525,000
Total	$ 5,490,754	36.1	$ 1,984,246	$ 7,475,000

Through estimated prices for three programs (1976 D-H, 1977 E-H and 1978 F-H) indicate a turnkey markup of thirty per cent or less, the estimate for 1979 reflects a higher markup, 71.7 per cent. It is pointed out this is still less than the 93 per cent awarded by the tax court (Haass vs. Commissioner 55 T.C. 43 (1970).

Each of the turnkey contracts sets out an "approximate" number rather than a "specific" number of wells to be drilled, recompleted and/or plugged. This is to permit the General Partner the flexibility necessary to develop the various leases or projects in the most efficient manner, taking advantage of all geologic and reservoir information as it became available. Thus, the General Partner could delete or add wells to a project as the new information dictated. For this reason, the number of wells actually drilled in a project will vary with the number estimated prior to development.

Exhibit V-A was prepared to reflect estimated prices for the number of wells actually drilled, recompleted and/or plugged. These estimated prices were then compared to the turnkey drilling contract prices. This comparison shows that based on the actual number of wells drilled, estimated prices result in an overall indicated turnkey

markup of only 16.0 per cent. The following table presents pertinent information extracted from Exhibit V-A.

Partnership	Estimated Prices	Turnkey Markup Per Cent	Turnkey Markup Amount	Turnkey Contract Price
1976 D-H	$ 786,340	8.1	$ 63,660	$ 850,000
1977 E-H	1,714,305	16.2	285,685	2,000,000
1978 F-H	2,258,176	(7.0)	(158,176)	2,100,000
1979	1,682,479	50.0	842,521	2,525,000
	$ 6,441,300	16.0	$ 1,033,700	$ 7,475,000

Finally, it is concluded that overall pricing stated in the four turnkey drilling contracts is in keeping with similar charges by other parties in the subject areas during the 1976-1979 time frame.

* * *

[LOGO] **Peat Marwick**

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To: The defendants in Civil Action No. 83C-179E

DELAWARE FLOOD COMPANY, a limited partnership under the laws of Oklahoma; LAYTON OIL COMPANY, a Kansas corporation; WILLIAM DOUGLAS LAYTON, individually and as general partner of DELAWARE FLOOD COMPANY 1976 DH; DELAWARE FLOOD COMPANY 1977 EH; DELAWARE FLOOD COMPANY 1978 FH; and DELAWARE FLOOD COMPANY 1979, LTD., limited partnerships under the laws of Oklahoma; and M. MICHAEL GALESI

We have performed certain agreed upon procedures as described below to the books and records of the Delaware Flood Company 1976 DH Limited Partnership, the Delaware Flood Company 1977 EH Limited Partnership, the Delaware Flood Company 1978 FH Limited Partnership, and the Delaware Flood Company 1979 Limited Partnership (the defendant limited partnerships) for the period from inception until February 28, 1987 (the period of the accounting) pursuant to Civil Action 836-179E.

We prepared the accounting required by the Court Order entered on March 18, 1987 (the Order) as supplemented and amended for the defendant limited partnerships. Section 1.01.02 of this report enumerates the requirements of the Order and the manner of compliance

therewith. Section 1.01.03 of this report is a copy of the Order. The indices following this letter reference the financial statements and schedules required by the Order. These sections are included in this letter by reference.

In addition, we make the following assertions.

1. We have expended in excess of 1,600 hours since January 1, 1988 in the preparation of this accounting dated April 14, 1988 pursuant to the Order (see detail at 1.01.07) and are independent of the defendant limited partnerships and other defendants pursuant to the second general standard adopted by the American Institute of Certified Public Accountants (AU Section 150.02).

2. Based upon our review of the records of third parties and reconciliations of the cash accounts, the revenues of the defendant limited partnerships for the period of the accounting appear reasonably stated.

No. 03-391

IN THE

Supreme Court of the United States

MICHAEL GALESI, DELAWARE FLOOD COMPANY,
a limited partnership under the laws of Oklahoma;
DELAWARE FLOOD COMPANY 1976 DH;
DELAWARE FLOOD COMPANY 1977 EH;
DELAWARE FLOOD COMPANY 1978 FH;
DELAWARE FLOOD COMPANY 1979 Ltd.,

Petitioners,

v.

BERNARD OLCOTT,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

I. Whether the Tenth Circuit Court of Appeals correctly affirmed the District Court's issuance of a rescissionary default judgment in favor of a limited partner investor against the general partner promoters for the return of the investor's $1,900,000 investment, where: (1) the promoters *admittedly* did not apply any of the invested funds to the partnership investments; (2) the promoters in bad faith obtained a *de facto fourteen year* continuance of the trial[1] upon their false promise to render a formal and meaningful accounting of the actual use, disposition and ultimate recipients of the invested funds; and (3) the promoters for 14 years willfully failed to furnish the accounting?

II. Whether the Tenth Circuit Court of Appeals can be faulted for affirming said District Court's award of prejudgment interest from the time of the investment under the circumstances?

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1. Petitioners' former counsel testified, and the District Court found, that Petitioners consented to render an accounting for the sole purpose of obtaining a continuance of trial and thereafter refused to do so. (Petitioners' Appendix 48-49 hereinafter "PA").

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Respondent investor Bernard Olcott ("Olcott") submits that the Petition for a Writ of *certiorari* filed by promoter Petitioners Michael Galesi, et al ("Petitioners") should be denied. The Tenth Circuit Court of Appeals correctly found that it was not an abuse of discretion for the District Court to enter a rescissionary default judgment for the amount of the Respondent limited partner's investment together with prejudgment interest thereon (less certain stipulated credits) as the result of the Promoters' failure to apply any of the invested proceeds to drilling partnership oil wells,[2] coupled with Petitioners' repeated and willful failure to comply (over a *14* year period) with *consent* accounting orders. Said orders required the Petitioners to identify the ultimate recipients of the limited partners' funds, as well as the actual uses and purposes to which the partners' funds had been applied.

The published decision by the United States Court of Appeals for the Tenth Circuit in *Olcott v. Delaware Flood Company, et al.*, 327 F.3d 115 (10th Cir. 2003) (hereinafter "Olcott III")[3] (Petitioners' Appendix 1-21, hereinafter "PA")[4] correctly affirmed the United District Court for the Northern District of Oklahoma's June 7, 2001 judgment.

STATEMENT OF THE CASE

A. Procedural History And Counter Statement Of The Facts

Given the intertwined nature of the statement of facts and procedural history, it would be impractical to have a separate recitation of same.[5]

---

2. ¶5 of the June 6, 2001 Findings of Fact. (PA 26).

3. The Court of Appeals also issued a published opinion in this matter in *Olcott v. Delaware Flood Co.*, 76 F.3d 1538 (10th Cir. 1996) (hereinafter "*Olcott II*"). (PA 69-117).

4. Respondent's Appendix is referenced herein as "RA."

5. The Court of Appeals in *Olcott II* described this matter in 1996 to be an "interminable saga," having a procedural history of "Byzantine (Cont'd)

The underlying suit, commenced on July 7, 1982 in the United States District Court for the District of New Jersey, arises out of the solicitation, sale and operation of oil and gas limited partnerships by promoter-Petitioner Michael Galesi ("Galesi") and his owned and/or controlled co-promoter co-petitioners. PA 128-130. The matter was later transferred to United States District Court for the Northern District of Oklahoma on *forum non conveniens* grounds in 1983.

As noted by the Court of Appeals in *Olcott II* (RA 108-109) and *Olcott III* (RA 3-4), after unsuccessfully attempting to employ more traditional discovery means, Mr. Olcott had no recourse but to seek to have the Petitioners render an accounting of all partnership assets and income. At a March 4, 1986 pre-trial conference, Petitioners agreed to render "a full, complete, meaningful, and formal accounting . . . setting forth all items of contribution, income, and expense as well as the disposition of all assets and monies. . ."[6] in exchange for a six (6) month postponement of the trial scheduled for March 17, 1986.

As the Court of Appeals in *Olcott III* noted:

> Mr. Olcott sought an agreement about the accounting for the purpose of discovery. The central question posed by Mr. Olcott's Rule 10b-5 lawsuit was what happened to the money he invested. His allegation of fraud centered on the defendants' alleged improper allocation of this money either to activities *ultra vires to* the limited partnership agreements or the

(Cont'd)

proportions." In *Olcott III*, the Court of Appeals, in conclusion, wrote:

> Plaintiff's claims have been pending before the federal courts for over twenty years. Defendants' willful refusal to comply with the district court's discovery orders is a significant source of the delay. Enough is enough. PA 21.

6. *Olcott II* at PA 95.

> defendants' improper commingling of partnership assets. Thus an accounting was necessary for Mr. Olcott to prove fraud.

(PA 108).

However, Petitioners never rendered the accounting that they agreed to furnish, notwithstanding the four separate opportunities the District Court afforded them to do so. The Petitioners put the Plaintiff and the trial court through *four* accounting sufficiency hearings, by falsely claiming each time that they had complied with said accounting orders, only to have the Court find noncompliance.

By Order dated March 17, 1987, the District Court found the Petitioners' first purported accounting to be grossly deficient, directed the Petitioners to submit a new accounting and ordered that the Petitioners would have to pay Mr. Olcott's reasonable legal and accounting fees incurred on accounting sufficiency issues until the same were resolved.[7]

By Order dated February 8, 1990, the District Court found Petitioners' repeated noncompliance with their accounting obligations to be willful and in bad faith. In so finding, the District Court noted that Petitioners' former counsel testified that the Petitioners' *sole* purpose in consenting to render an accounting was to obtain a continuance of the March 1986 trial date; Petitioner Galesi[8] never intended to furnish Mr. Olcott with an accounting; and when pressed by his counsel to belatedly furnish the accounting, stated that he would rather "take my chances" with the Court (PA 36). Accordingly, the District Court in its February 9, 1990 Order entered a default "judgment" in the principal amount of $1.9 million (Mr. Olcott's investment)

7. Although characterized as a sanction, this provision merely served to partially reimburse Mr. Olcott for legal and expert accounting fees incurred and to be incurred in the contested accounting sufficiency necessitated by Petitioners' conduct.

8. An entrepreneur/attorney who was found by the District Court to control the defense as well as the affairs of all of the Defendant-Petitioners.

less any portions of *those funds* that the Petitioners could demonstrate at a set-off hearing[9] to have been actually used in the performance of limited partnership turnkey development work. The Order also required the Petitioners to file a true and meaningful (supplemental) accounting by May 31, 1990.

Petitioners' Purported 'Fourth Accounting'

On May 18, 1990, the Petitioners filed a Motion to Modify Accounting Order (District Court docket number 680 hereinafter "doc. no.") which is notable for the Petitioners' assertion at page three that "neither the Petitioners, nor anyone else will be able to prove that a particular dollar of Mr. Olcott's went directly into a particular well."[10] The District Court denied the Petitioners' motion by Order dated July 2, 1990 (doc. no. 686).

On May 31, 1990 the Petitioners filed their fourth "accounting" entitled "Submission of Supplemental Accounting" which was nothing more than 90 pages of handwritten notations made on prior schedules by Petitioners' in-house accountant. On June 22, 1990, Investor's now deceased expert accountant (Jim T. Spears, CPA) prepared a report which contains an analysis of the many deficiencies of Promoters' "Supplemental Accounting."[11] On July 24, 1990 the Petitioners

9. Although the District Court's February 8, 1990 Order used the term "trial" in referencing the set-off hearing, it is clear from subsequent orders and at the August 2000 pre-trial conference that it was supposed to be a damages (or "set-off") hearing, not a trial on the merits. *See* discussion on the District Court's sole focus on "direct proof" of "where the money went" on pages 11-12, 18-19, *infra*. *See also* discussions as to the entry of default judgment precludes trial on the merits at page 19-20, *infra*.

10. However, the Petitioners purposely withheld the fact (ultimately admitted by the Petitioners, and stipulated to on the last day of the set-off trial) that *none* of the Mr. Olcott's—or the other limited partners'—funds were utilized by the Petitioners for drilling *any* of the wells!

11. Said report is attached as Exhibit "C" to Investor's Third Renewed Motion For: (1) sanctions for Defendants' noncompliance with (Cont'd)

filed a most disingenuous 'Response' falsely claiming that *all* of Mr. Olcott's funds had been used for legitimate purposes. (*See* doc. no. 692)

On September 26, 1990, the trial court's expert, Charles Ostrander, CPA filed his report that found Petitioners' fourth accounting to be once again deficient.[12] Accordingly, on July 5, 1990, Mr. Olcott filed his Third Renewed Motion: (1) For Sanctions For Petitioners' Non-Compliance With The District Court's Discovery Orders And Their Failure To Purge Themselves Of Earlier Failure To Comply; and (2) For The Entry Of Final Judgment (For Rescission) (doc. no. 687). However, Mr. Olcott's motion was never heard by the District Court.

Dismissal of Petitioner's Claims and *Olcott II*

By order dated September 25, 1991 (doc. no. 780), all of the Petitioners' claims were dismissed by the District Court pursuant to this Court's holding in *Lampf, Pleva, Lipkind, Prupis and Petigrow v. Gilbertson*, 501 U.S. 350, 111 S. Ct. 2773 (1991), which shortened the statute of limitations for a federal securities fraud claim and was retroactively applied to Mr. Olcott's case.

Notwithstanding the dismissal, the District Court in its April 30, 1993 Order (PA 58-68) sanctioned the Petitioners for their failure to comply with the Court's accounting orders by ordering Petitioners to pay $402,527.98 (representing a fraction of the attorneys' fees and costs that Mr. Olcott actually incurred during the sufficiency accounting hearings during the period of through December 19, 1986 through October 15, 1987). The District Court also held that it had jurisdiction to enter such

(Cont'd)
discovery orders and their failure to purge themselves of earlier failures to comply; (2) entry of final judgment (for rescission) against all Defendants jointly and severally; and to vacate the February 8, 1990 stay of fee award process (doc. no. 687).

12. Said report is attached to the District Court's December 29, 1990 Order (doc. no. 716).

a sanction, as it was analogous to a Rule 11 sanction under the analysis in *Willy v. Coastal Corp.*, 503 U.S. 131, 112 S. Ct. 1076 (1992).

The parties appealed to the United States Court of Appeals for the Tenth Circuit. In *Olcott v. Delaware Flood Company*, 76 F.3d 1538 (10th Cir. 1996) ("Olcott II"), the Court of Appeals affirmed in part, reversed in part and remanded the matter to the District Court. The Tenth Circuit held that District Court had jurisdiction to enter a sanction order pursuant to *Willy*, since said sanction was more akin to a Fed. R. Civ. P. 11 than a civil contempt citation. The Court of Appeals also declined to reduce the $1.9 million default judgment to final judgment because the "[district] court never entered a final order on this topic." The Tenth Circuit decision, however, also approved the District Court to revisit the default judgment issue on remand.

By Order dated May 5, 1997, the District Court retained jurisdiction over Mr. Olcott's pendent state claims noting that:

> . . . in this case judicial economy dictates that the court retain jurisdiction . . . and . . . also . . . the inordinate delay caused by the defendants in attempting to avoid providing an accounting dictates that, in fairness to plaintiff . . .

(doc. no. 903).

Petitioners' Motion For Summary Judgment

Emboldened by the District Court's earlier decision to defer rulings on Mr. Olcott's motions pertaining to the inadequacy of their 'fourth accounting' until the set-off hearing, Petitioners filed a motion for summary judgment on November 10, 1998 (doc. no. 944 and 945) falsely arguing that that to comply with the District Court's *consent* accounting orders, all they need to show was that Mr. Olcott's monies went to the alleged drilling

contractor (Layton Oil Co.).[13] The District Court rejected the Petitioners' bad faith arguments in its September 29, 1999 Order (doc. no. 972):

> . . . Defendants now argue that they are entitled to summary judgment because under the terms of the parties' agreements, Olcott's money could only be used and was used to pay the turnkey drilling contractor for specified drilling and intangible development work for a specified price. They further argue that because the . . . turnkey drilling contractor (allegedly) performed its obligations under each turnkey drilling contract . . . Olcott received the benefits which he bargained for . . .
>
> *This rather circular and conclusory argument appears to be an additional attempt to avoid accounting for the use of funds as has been required by this Court and was, in fact a requirement of the contract.*[14] The clear purpose of the court's order granting the default judgment was to force Defendants to account for the use made of the turnkey drilling monies contributed by the limited partners, and if unable (i.e., unwilling) to do so, repay Olcott his investment. Therefore, to argue that the monies were used to pay the turnkey drilling contractor is of no help whatsoever to the analysis and defeats the purpose and intent behind the default judgment. The clear wording of the Court's Order regarding the default judgment, as well as subsequent orders and discussion explaining it, are clearly dispositive of Defendants' motion.

(Emphasis added).

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13. Whose principals were the same as the principals of the general partner of the limited partnerships.

14. i.e., the limited partnership agreements (which required segregation of the partnership funds and limited the use of same to partnership purposes).

Undaunted, the Petitioners filed a motion on October 25, 1999 (doc. no. 974) for reconsideration. In its December 14, 1999 Order (doc. no. 987) the District Court rejected the Petitioners' frivolous proposition and held:

> The gravamen of Defendants' argument is that, because the contract was a 'turnkey drilling contract', the money paid could legitimately be used on anything the Defendants desired. This Court has considered this argument numerous times, and rejected it. *If that position was legitimate, this Court never would have ordered an accounting and Defendants never would have agreed to provide an accounting as an alternative to trial. Defendants appear to deliberately misunderstand the language and intent of the default judgment. Under that judgment, Defendants, in order to offset that judgment, must demonstrate that plaintiffs' funds were used to drill the wells required to be drilled in the contracts.*

(Emphasis added).

Despite the District Court's clear rejection of the arguments advanced in their motions for summary judgment and for reconsideration, Petitioners recycled the *same arguments* at the August 10, 2000 Pre-Trial Conference; the August 29, 2000 set-off hearing; in the February 8, 2002 Motion For a Stay Pending Appeal (doc. no. 1125) which the District Court denied in its March 14, 2002 Order (doc. no. 138). The Petitioners have continued to recycle this frivolous argument in their Opening Brief (doc. no. 1507055) filed on May 1, 2002 on Appeal; and their Motion For A Stay Pending Appeal (doc. no. 1510574) filed on May 14, 2002 with the Court of Appeals; and in their Petition for a Writ of *Certiorari* filed on September 8, 2003 with this Court.

Merger of Mr. Olcott's State Claims

Contrary to Petitioners' repeated false assertions, *the District Court never dismissed Mr. Olcott's state law tort, fraud and breach of contract claims* but rather *merged* these rescissionary claims with its default judgment thereon:

a) As noted in *Olcott III*, the district court specifically ruled that Mr. Olcott's remaining claims would merge into its default 'judgment' at a January 14, 1998 conference:

> I further find and order that [Plaintiff's remaining claims] *merged* into the 1.9 million dollar judgment of this Court.

b) In a February 28, 1998 Order, the district court ruled that Mr. Olcott's rescissionary fraud and breach of contract claims would be deemed merged into its default judgment, and not be tried during the set-off hearing because:

> Plaintiff has stated . . . that he wishes to accept the $1.9 million default judgment, but that he wishes to be able to put on evidence for his fraud case as well . . . Plaintiff has already received a judgment in his favor entitling him to the same damages. *In the interest of efficiency and judicial economy, the trial of this matter is limited to the issues encompassed by the default judgment previously entered.*

(Emphasis added) (PA 121).

c) During the August 10, 2000 Pre-Trial Conference, the District Court reaffirmed the merger of Mr. Olcott's breach of contract and fraud claims into the $1.9 million sanction judgment :

> THE COURT: . . . This is not a contract case. *The contract case and the fraud merged* into the Court's $1.9 million judgment that was recited by the Court at an earlier hearing.[15]
>
> . . .
>
> PETITIONER' COUNSEL (MR. SEYMOUR): . . . the issue here was the contract fulfilled. There are contract defenses. Some of them are set forth in –
>
> THE COURT: The contract action has *merged*; it has *merged*, it's gone and it doesn't exist anymore. (emphasis added)

(8/10/00 Tr:4:5-12; 13:3-12; 21:11-17 attached as Exhibit "C" to Answering Brief of Appellee).

d) Finally, in its June 6, 2001 Findings of Fact and Conclusions of Law, the District Court stated (PA 25):

> On remand this Court granted summary judgment on a number of claims and held that the remaining claims *merged* into the $1.9 million default judgment award entered in 1990.

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15. Referring to the Court's previously referenced statement set forth in the January 14, 1998 Pre-Trial transcript (36:16-20).

August 9, 2000 Pre-Trial Order

The Pre-Trial Order, which was entered by the District Court on August 9, 2000, predicates jurisdiction "upon the May 5, 1997 Order of the Hon. James Ellison, U.S.D.J., *wherein this Court ruled that this Court would retain jurisdiction over Plaintiff's pendant state claims.*"[16] (Emphasis added) (PA 128).

August 10, 2000 Pre-Trial Conference[17]

The District Court emphasized what kind of 'proof' was required when counsel for Promoters once again raised their 'benefit-of-bargain' argument:

> MR. SEYMOUR: . . . But if you look at the language utilized for legitimate purposes under the terms of the agreement among the parties from a contract standpoint . . . did the plaintiff get the benefit of his bargain?
>
> THE COURT: We've passed that. We've passed that. We're dealing only with the sanction order at this point.
>
> . . .

16. As noted by the Court of Appeals in *Olcott III*, although the Pre-Trial Order at one part erroneously characterized the February 8, 1990 Order as dismissing Mr. Olcott's remaining claims, it is clear from the Order as a whole, as well as from prior and subsequent District Court Orders and statements, inclusive of the Court's statements at the August 10, 2000 Pre-Trial conference, that Mr. Olcott's claims were never dismissed (PA 9-12). *Olcott III* held that both parties were well aware that Mr. Olcott's claims were still viable (PA 12).

17. Although the Petitioners were not entitled to a hearing by jury as a matter of law (*see Olcott III* at PA 15-16), the District Court afforded the Petitioners an opportunity to submit a brief with authorities on the issue of their entitlement to a jury trial. However, Petitioners only submitted a one-page 'jury demand' without citing any authority and such inadequate submission constitutes as a waiver of the relief sought.

> MR. SEYMOUR: . . . We believe...the issue here is was the contract fulfilled . . .
>
> THE COURT: The contract action has merged . . . *Where did the money go, that's always been the question.*
>
> . . .
>
> THE COURT: . . . I'm not going to spend much time listening to irrelevant matters. If anything comes in that is not relevant, it certainly won't be included in my findings. . . The February 1990 findings define the scope really of the *accounting evidence* that would be acceptable. . . *It has to be direct evidence where the money went.* Seymour tells me that they are able to do that. . . I think that's *what we're curious about, is where the money went.* That's where we started and that's where we'll end. Okay.

(8/10/00 Tr. 12: 20-25; 13:1-3; 21:14-20; 22:24-25; 62:15-25; 63:17-19; 64:4-7 attached as Exhibit C to Mr. Olcott's Answering Brief filed in *Olcott II*).

The District Court made it abundantly clear that such "direct-proof" can only be met by *accounting* testimony and *monetary* proofs:

> THE COURT: They are simply going to have to address the issue of the accounting, and that's *all you're going to have is accounting testimony at this point. . .*
>
> MR. FEINSILVER: If I can just follow this through. . . If we're told that checks went to the bank, what does that do for us? I think it's a money proceeding, is the tracing funds.

> THE COURT: . . . *has to be direct evidence where the money went. Seymour tells me that they are able to do that. . .*[18]

8/10/00 Tr. 61:12-64:7.

The August 29 – September 1, 2000 'Set-Off' Hearing

During the first day of the set-off hearing, the District Court once again re-iterated the evidential parameters of the case:

> THE COURT: . . . We are not going back into any issues not addressed in the Court's February 8, 1990 findings of fact and conclusions of law. . . *We're not going beyond that. . . We're not going to relitigate anything that has been dealt with by summary judgment.*

(Emphasis added). *See* Appendix of Appellants 316-317 hereinafter "Aplt.App."

The District Court's Modification Of Its Pre-Trial Order In Petitioners' Favor

Contrary to the Petitioners' wholly unsupported contention that a trial court cannot subsequently modify its pre-trial order, a court may at any time even after the close of proofs do so. *See* Baiker-McKee, Federal Civil Rules Handbook, Authors' Commentary on Rule 16(e), page 399 (2003 edition) ("Where its modification will not unduly prejudice the opposing party, the court has discretion to modify a pretrial order to prevent manifest injustice.") In this matter, the District Court ultimately reversed its 1997-2000 pre-trial rulings and pre-trial order provision, which denied Petitioners any credit or set-off for distributions made to Mr. Olcott prior to Mr. Olcott suing for

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18. But for this representation, there would have been no set-off hearing. The District Court at the Pre-Trial conference expressly urged the Petitioners not to put the Court and parties through an unnecessary hearing if the Petitioners were unable to prove their actual use and disposition of the Investor's funds (in drilling partnership wells). 8/10/00 Tr.61:12-64:7.

rescission, and for monies that Promoter Galesi had paid to Mr. Olcott on a separate "put" judgment. (awarding Petitioners credits for $623,161.00 in income distributions and for $199,824.30 on the "put" lawsuit judgment that Mr. Olcott obtained against Petitioner Galesi).[19] The Petitioners were also allowed, over Mr. Olcott's vigorous objections, to present incompetent anecdotal narrative proofs to the effect that sufficient wells of unknown depths were ultimately drilled (for the limited purpose of making a record on appeal).

However, the set-off hearing is most notable for the startling testimony (on cross-examination) of Petitioners' accountant (and former controller) Charles Underwood, CPA, who admitted on the third day of the hearing, that "*very little, if any*" monies put up by any of the limited partners for any of the limited partnership programs was used by any of the Promoters in the performance of the turnkey contract work for any of the partnership programs (Aplt.App. 697). Mr. Underwood testified that he was "comfortable" with said stipulation, because: "THE WITNESS: *That's* what happened, Your Honor." (Aplt.App. 697). To curtail Olcott's line of questioning thereon, on September 1, 2000 the Petitioners stipulated on the record:

> *NONE* OF THE MONEY THAT WAS CONTRIBUTED FOR ANY OF THE FOUR PROGRAMS . . . WAS SPENT ON *ANY* OF THE FOUR DRILLING PROGRAMS.

(Aplt.App. 765).

The stipulation itself, as well as Mr. Underwood's aforestated admission, conclusively demonstrated *that the*

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19. Petitioner Galesi had represented to Mr. Olcott at the time of his 1987 investment that all of the oil leases were in Kansas. Upon the Investor learning that some leases were in Arkansas, Defendant Galesi, an attorney, drafted a 'put' option contract therefore, which Mr. Olcott exercised and sued Petitioner Galesi thereon. *See* District Court's Findings of Fact 13 and 14 at Apt.App. 267-268. *See also* Aplt.App. 9236-9239.

Petitioners knew on March 18, 1986, when the initial consent stipulation and (accounting) order (doc. no. 124) was entered, that none of the limited partners' contributions were actually used for the turnkey contract work! Thus, they knew on February 8, 1990, that the District Court's default sanction judgment formula afforded them *no* set-off whatsoever to Mr. Olcott's $1.9 million rescissionary default judgment.

Petitioners' "Fifth Accounting"

The only certified public accountant expert, sought to be qualified at trial to testify as an expert, was Charles H. Ostrander, CPA (who had previously acted as the Court's expert—but was called as Plaintiff's expert due to the death of Mr. Olcott's former expert James T. Spears, CPA).[20] Mr. Ostrander agreed to testify on behalf of Mr. Olcott at the trial after Mr. Olcott obtained an order from the District Court authorizing same.

After reviewing the Petitioners' purported 5th accounting, as well as all other exhibits produced by Petitioners, Mr. Ostrander testified *without contradiction*[21] that the Promoters never cured most of the deficiencies cited in his prior reports.[22] (Aplt.App. 735-748, 9502-9700). The District Court adopted the uncontradicted testimony of Mr. Ostrander that the Promoters 'fifth' accounting failed to comply the District Court's accounting orders.

Accordingly, on June 6, 2001, Hon. James O. Ellison, Senior Judge, who had presided over all proceedings below since 1983, awarded a final rescissionary default judgment in the principal

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20. Mr. Olcott's former accountant expert, Jim Spears, CPA, had testified for the Mr. Olcott in the three prior plenary hearings. On or about July 12, 1998, Mr. Spears unexpectedly passed away.

21. Petitioners did not present any rebuttal witnesses, or other rebuttal evidence at the trial to controvert Mr. Ostrander's testimony.

22. At pages 20-21 of Mr. Olcott's Answering Brief filed in *Olcott III*, Mr. Olcott sets forth in detail Mr. Ostrander's testimony regarding the numerous deficiencies in Petitioners accounting.

amount of $1,077,014.70, plus pre-judgment interest (to be quantified). (PA 24-30).

In its post judgment January 29, 2002 Order, the District Court, in relevant part, quantified the prejudgment interest award in the amount of $1,679,144.55. (PA 51-55). Petitioners appealed the District Court's June 7, 2001 judgment and January 29, 2002 order to the United State Court of Appeals for the Tenth Circuit.

Olcott III and Subsequent Proceedings

On April 24, 2003, the Court of Appeals in *Olcott III* (PA 1-21) affirmed the judgment and damage award, but remanded with instructions to recalculate the prejudgment interest award in conformance with New Jersey law. In affirming the District Court's judgment, the Court of Appeals held: (i) the District Court was not divested of subject matter jurisdiction, as it had not dismissed Mr. Olcott's pendant state law fraud and breach of contract claims (which it "merged" into the default judgment award); (ii) alternatively, even if Mr. Olcott's claims had been dismissed, the District Court would be found to have properly retained jurisdiction herein for the purpose of enforcing its sanction orders; (iii) the Petitioners were not entitled to a jury as a matter of law at the damages (or set-off) hearing; (iv) Petitioners' merit-based arguments were foreclosed by the entry of default judgment; and that (v) there was substantial evidence to support the District Court's determination that Petitioners' latest accounting failed to comply with previous accounting orders.

Upon remand, the District Court, by order dated July 10, 2003 (doc. no. 1154), in part, directed the Mr. Olcott to submit a proposed prejudgment interest calculation pursuant to New Jersey law. Petitioners were directed to file any objection thereto. Mr. Olcott filed a proposed prejudgment interest calculation in the amount of $2,573,974.77. Petitioners never filed an objection thereto. Accordingly, in its August 27, 2003 Order (PA 56-57), the District Court awarded pre-judgment interest in the aforementioned amount.

REASONS FOR DENYING THE PETITION

A. Contrary To Petitioners' Repeated False Assertions, Mr. Olcott's State Law Fraud and Breach of Contract Claims Were *Never* Dismissed By The District Court And The District Court Thus Had Subject Matter Jurisdiction When It Entered Judgment.

The Defendants' Petition is entirely predicated upon a false claim that the District Court dismissed Mr. Olcott's fraud and breach of contract claims in 1998 (instead of merging same into its rescissionary default judgment). No motion was pending to dismiss these viable claims at the time Petitioners allege that such dismissal occurred. The Petitioners nowhere suggest any bonafide substantive or procedural reason as to *why* the District Court would have made such a dismissal disposition in a then 16 year old case already on remand. In fact, no such reason exists.

The Petitioners ask this Court to find that the District Court *inadvertently* divested itself of subject matter jurisdiction without cause, and that all subsequent proceedings conducted by the District Court (including the damages hearing) were therefore for naught.

Petitioners rely on a single misstatement in the non-dispositive "Statement of the Case" section of the District Court's August 9, 2000 Pre-Trial Order as the sole basis for their contention that all of Mr. Olcott's causes of action were dismissed:

> The Court further held [in its February 4, 1998 Order] that "in the interest of efficiency and judicial economy the trial of this matter is limited to the issues encompassed by the default judgment previously awarded" by the February 8, 1990 Order. Hence, Plaintiff's claims . . . *dismissed*.

(Emphasis added) (PA 126).[23]

23. Of which the District Court and counsel apparently overlooked.

However, the very same pre-trial order provides at Section II, entitled "Jurisdiction:"

> 3. Jurisdiction is predicated upon the May 5, 1997 Order of the Hon. James O. Ellison, U.S.D.J., wherein this Court ruled that this Court would retain jurisdiction over Plaintiff's pendant state claims. (PA 128)

Accordingly, and as the Court of Appeals in *Olcott III* correctly pointed out, notwithstanding such singular erroneous statement, the District Court clearly did *not* dismiss Mr. Olcott's fraud and breach of contract claims in the February 4, 1998 Order (PA 10):

> Instead, the order noted that these claims were still viable but that, in the interest of judicial economy, "Plaintiff [would not be allowed] to put on evidence to prove a fraud claim when Plaintiff has already received a judgment in his favor entitling him to the same damages." The district court never dismissed Plaintiff's fraud and breach of contract claims.

See also the District Court's February 5, 1998 Order (PA 118-121).

The Court of Appeals further correctly observed:

> Reading the pre-trial order *as a whole* clarifies that 'in the interest of efficiency and judicial economy' the district court 'merged' these claims into the default order, in effect placing all substantive matters on hold pending resolution of the default order.

(Emphasis added). *Olcott III* at PA 10. Reading the Pre-Trial Order in its entirety, it is clear beyond dispute that on ¶3 at PA 128, the District Court (pursuant to the May 5, 1997 Order) *retained jurisdiction* over Mr. Olcott's pendant state claims.

The Court of Appeals also noted that:

> . . . the [District] Court's intent to resolve the accounting matter rather than try Plaintiff's claims on the merits was evident. Although the court did not use the correct legal terminology, the court made its intention perfectly clear at every status conference, at the pre-trial conference, and during the set- off hearing.

Olcott III at PA 10. *See* discussions at pages 9-10, *supra*, where the District Court reiterated on numerous occasions that Mr. Olcott's state law claims *merged* into the default judgment.

B. The Court of Appeals Properly Affirmed The District Court's Rejection of Petitioners' 'Uncontroverted' Evidence And No Constitutional Right To Due Process Is Implicated.

1. The February 8, 1990 Order Required The Petitioners To Produce "Direct Proof" In Support Of Any Claimed Set-Off Credit They May Have From The Default Judgment.

As noted by the Tenth Circuit in *Olcott III*, the February 8, 1990 Order and the August 10, 2000 Pre-Trial Conference delineated the "direct proof" that Petitioners must introduce at the set-off hearing:

> The court's February 8, 1990 order entering default stated that Plaintiff was entitled to reimbursement of the $1.9 million he invested in the partnership interests, but that the damage award would be reduced to the extent Defendants could establish "to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate business purposes." The court later clarified that evidence in support of any claimed off-set was limited to "direct proof" in the form of an accounting directly *tracing Defendants' use of Plaintiff's funds*.

> Defendants failed to introduce any evidence in the form required.

(Emphasis added) (PA 17).

The District Court repeatedly advised the Petitioners during the August 10, 2000 Pre-Trial Conference and at the first day of the set-off hearing of the "direct proof" requirement (*see* pages 11-13, *supra*). Indeed, Petitioners' counsel represented to the District Court at said Pre-Trial Conference that Petitioners would be able to furnish such proofs:

> THE COURT: I'll simply enter this order, the proof that will be required is the proof that's set forth in the Court's February 1990 order . . . it's direct proof . . . If you are unable to present the proof as required, then it would be a futility to go forward.
>
> MR. SEYMOUR: *Our position, Your Honor, would be that we will be able to present the proof that is required under that order . . .*
>
> . . .
>
> THE COURT: I've spent I thought the morning defining of what could be presented. *It has to be direct evidence where the money went. Seymour tells me that they are able to do that.*

(Emphasis added) (8/10/00 Tr. 40:2-17; 61:12-64:7 attached as Exhibit C to Mr. Olcott's Answering Brief filed in *Olcott II*).

Accordingly, the District Court found that Petitioners failed to meet the "direct proof" requirement pursuant to the following June 6, 2001 Findings of Fact and Conclusions of Law (PA 26-29):

> 5. Promoters stipulated that none, or virtually none, of the investment of the limited partners

(which were paid . . . in payment of the obligations under the turnkey drilling contracts) were used . . . on the wells in the four Programs . . .

15. Promoters have failed to render an accounting and have not accounted for the specific use of Investor's moneys.

17. With the exception of the credits for monies actually received by Investor, the Promoters have failed to meet the "direct proof" requirement as to credits against the $1.9 million judgment. Specifically, the Court rejects, as it has done before in its rulings on Promoters' motion for summary judgment and motion to reconsider, Promoters' evidence regarding its fulfillment of its obligations under the four turnkey drilling contracts on the four programs as proof of any credit on the judgment. In light of the stipulation at finding of fact no.5, above, such proof simply does not satisfy the terms of the sanction levied by the Court in its Order of February 8, 1990.

2. The Entry of The February 8, 1990 Default Judgment Precluded Any Defenses On The Merits.

An entry of default judgment precludes a defendant from defending a claim on the merits. *Olcott III* at PA 17-18 *citing Jackson v. FIE Corp*, 302 F.3d 515, 525 (La. App. 2002) ("Defendant by his default, admits the plaintiff's well-pleaded allegations of fact, is precluded from challenging those facts by the judgment, and is barred from contesting on appeal the facts thus established") and *Adriana Int'l Corporation*, 913 F.2d 1406, 1414 (Cal. App. 1990) ("[A] default judgment generally precludes a trial of the facts except as to damages.").

The District Court entered default judgment in the amount of $1.9 million (Mr. Olcott's investment) on February 8, 1990 after: (i) Petitioners failed on three occasions to comply with the Court's accounting and discovery orders; and (ii) Petitioner Galesi was found to have said to his former counsel that he would rather "take his chances" than render the consented to (and ordered) accounting. As a result, Petitioners were properly barred from having the District Court consider their incompetent anecdotal evidence to support any purported defense on the merits (to the effect that the drilling contracts were fulfilled and that Respondent got the benefit of his bargain).

Furthermore, pursuant to this Court's decision in *Randall v. Loftsgarden*, 106 S. Ct. 3143 (1986), those responsible to a defrauded investor are not entitled to a credit or offset for alleged tax benefits.

C. The District Court Did Not Sanction Petitioners Twice For The Same Conduct In Entering A Rescissionary Default Judgment. Olcott III Does Not Pose A Federal Question That Conflicts With Relevant Decisions Of This Court, Or With Other Circuit Courts.

The Petitioners falsely claim that the February 8, 1990 $1.9 million default judgment and the April 30, 1993 $402,000 counsel and expert fee award have caused them to be sanctioned twice for the same conduct.

Upon the close of the District Court's first accounting sufficiency hearing, it found that the Petitioners had: (a) not complied with the consent accounting orders; and (b) unnecessarily put Mr. Olcott through a plenary hearing (with experts) to prove same. Under such circumstances, the District Court, by Order dated March 17, 1989 (doc. no. 580), most properly, and equitably, ordered, in pertinent part, provided:

The Court having found noncompliance by the Defendants, the following sanctions shall be imposed:

> 1. The Defendant shall cure the remaining deficiencies in the accounting . . . issues within one (1) week of March 17, 1987.
>
> 2. Defendants shall pay all costs and fees incurred by the Plaintiff from December 19, 1986 regarding the accounting issues until all accounting issues are resolved . . .
>
> 3. Defendants shall pay the fees of the Court's appointed expert, Charles H. Ostrander for so long as his services are required in this litigation.
>
> . . .
>
> 5. The Plaintiff shall file an application for costs and fees to date within ten (10) days of March 17, 1986. Costs and fees which accrue subsequent to this hearing may be the subject of a supplemental application.
>
> . . .
>
> 7. If the Defendants do not comply with the terms of this Order as set forth above, the Court will, sua sponte, reconsider its ruling on the sanction requested imposed herein.

After the Petitioners once again filed a sham accounting, and once again needlessly dragged Mr. Olcott (and the Court) through a plenary hearing, only to have Mr. Olcott prove that their new accounting was sham, the District Court on October 14, 1987 (doc. no. 330) ordered in pertinent part:

> . . . under the circumstances of this case where Plaintiff has been required to again litigate the sufficiency of the accounting the Court determines that it is just that Defendants pay all fees and

> expenses of Plaintiff's counsel and Plaintiff's accountants incurred for services rendered in connection with resolving the sufficiency of the accounting. Plaintiff shall file the appropriate fee applications with supporting documentation on or before October 31, 1987. Defendants shall also pay the statement of the Court's expert, Charles Ostrander, in the sum of $14,275.00 Mr. Ostrander's fee shall be paid no later than October 21, 1987, and evidence of payment shall be filed with the Court.
>
> One final word of warning to the Defendants is necessary. This Court has previously had insufficient evidence of bad faith by Defendants to justify the entry of a procedural default. The Court has ordered the Defendants to be present before the Court on October 19, 1987 in order that the Court may personally address the requirements of the Court Order with the Defendants. Hereafter there will be no question that the Defendants were personally aware of the actions which they have been ordered to perform, and delegation of responsibility to surrogates will not relieve Defendants from the full panoply of sanctions for noncompliance.

Although the April 30, 1993 $402,000 award was couched as a Rule 11 sanction designed to punish the Defendants for their ongoing refusal to comply with the District Court's accounting and discovery orders, the effect of the award was to partially compensate Mr. Olcott for the attorneys fees and costs that Mr. Olcott incurred by the Petitioners to incur during the three accounting sufficiency hearings.

In contrast, the District Court's June 6, 2001 final default judgment, was a damage award predicated on Mr. Olcott's claim for rescission:

a) The District Court's February 8, 1990 Conclusions of Law provides, in pertinent part:

> 4. Plaintiff is entitled to a judgment . . . for *his investment* of $1.9 million dollars less any portion of those funds which Promoters can establish were utilized for legitimate purposes under . . . the Limited Partnership Agreements.

(Emphasis added).

b) This District Court's Order of September 29, 1999, provides, in pertinent part:

> . . . the clear purpose of the Court's order granting default judgment was to force Promoters to account for the use made of the turnkey drilling moneys contributed by the limited partners, and if unable to do so, *repay Olcott his investment*. . .

(Emphasis added).

c) This District Court's Order of January 29, 2002 (Aplt.App.296) provides, in pertinent part:

> The Court finds that its Judgment of June 7, 2001 included an award of pre-judgment interest and finds no merit in the arguments of Promoters to the contrary. *Clearly the sanction awarded Plaintiff was a default judgment based on a theory of rescission.*

(Emphasis added).

The Petitioners have also acknowledged same:

a) Petitioners' contention ¶5, of the August 9, 2000 Pre-Trial Order states, in pertinent part (PA 142):

> . . . the remaining controversy . . . is: What, if any, set-off Promoters can

> prove reducing the $1.9 million *default judgment* . . . awarded Investor . . . *in the form of a rescissionary return of his investment.*

(Emphasis added).

b) At the August 10, 2000 Pre-Trial Conference, Petitioners' counsel acknowledged:

> MR. SEYMOUR: . . . There has to be an analytical peg to deal with this $900,000 and to me, *the only place it's found is that these are rescissionary damages. He is wanting to be put in the position that he was before he got into this deal.*

(Emphasis added). 8/10/00 Tr. (20:11-17; 23:5-8).

D. *In Arguendo*, Even If The District Court's February 4, 1998 Order Had Dismissed All of Mr. Olcott's Substantive Claims, Said Order Was *Not* A Final Decision. Thus, The District Court Was Free To Correct Same Prior To Entering Final Judgment.

A court's dismissal of all substantive claims does not automatically deprive the court of authority to enforce a sanction order it previously entered. As *Olcott III* notes:

> A district court retains jurisdiction to impose and enforce sanctions until the court enters a final judgment. FN10 *See* Fed.R.Civ.P. 54(b) (any order that fails to adjudicate all rights and liabilities does not terminate the action). *See also 28 U.S.C. § 1291* (limiting appellate jurisdiction, which divests district court of jurisdiction over matters connected to the appeal, to final decisions of the district court). District court proceedings are not final until the district court has rendered a decision that ends the

> litigation on the merits and leaves nothing for the court to do but execute the judgment. *See Copeland, 136 F.3d at 1252.*
>
> FN.10 Contrary to Defendants' assertions, *Olcott II* does not dictate otherwise. In *Olcott II* the district court entered an order dismissing all claims and imposing a monetary sanction without referring to its prior entry of default. We found significant the district court's omission of any reference to the entry of default and concluded the district court intended "only to impose the [monetary] sanction [and] to abandon the default judgment as a sanction." *Olcott II* specifically ruled that the district court's judgment order dismissing all claims was a final decision. By contrast, every order the district court entered following remand expressly stated the district court's intent to enforce the entry of default . . .

Even assuming that the February 4, 1998 Order dismissed all of Mr. Olcott's substantive claims (which it did not), it expressly provided for subsequent proceedings on the default judgment:

> Plaintiff . . . wishes also to be able to put on evidence for his fraud case as well . . . In the interest of efficiency and judicial economy, the trial of this matter is limited to the issues encompassed by the default judgment previously awarded.

(PA 121). Thus, said order was interlocutory, and the District Court was free to modify same at any time. Indeed, same was superceded by the August 9, 2000 pre-trial order (which was itself modified in favor of the Petitioners at the final damages ('set-off') hearing, to give them credits of $623,161.00, which had been disallowed by prior motion rulings and the pre-trial order). There was no final order until the District Court issued the June 6, 2001 judgment (which quantified Mr. Olcott's damage award after the set-off hearing). Since the February 5,

1998 Order did not constitute a final decision, the District Court never lost jurisdiction to enforce its February 8, 1990 default judgment.

E. The Tenth Circuit's Decision In *Olcott III* Does Not Conflict with the Third Circuit's decision in *In re Orthopedic "Bone Screw" Products Liability v. Eyster*.

The pertinent issue raised in the cases cited by Petitioners is whether a district court can impose the extreme sanction of dismissal with prejudice without having subject matter jurisdiction. In the case at bar, the District Court was never divested of subject matter jurisdiction to enforce monetary sanctions pursuant to the February 9, 1990 rescionary default judgment and the April 3, 1993 Order.

Accordingly, the Tenth Circuit's decision in *Olcott III* does not implicate the issue raised in *In re Orthopedic "Bone Screw" Products Liability v. Eyster*, 132 F.3d 152 (3d Cir. 1997) and does not warrant a granting of *Certiorari*.

CONCLUSION

As the Court of Appeals in *Olcott III*, concluded:

> Plaintiff's claims have been pending before the federal courts for over twenty years. Defendants' willful refusal to comply with the district court's discovery orders is a significant source of the delay. *Enough is enough.*

(Emphasis added) (PA 21). The Petition submitted to this Court contains nothing more than a repeated mischaracterization of the record (inclusive of so-called "uncontroverted" evidence) that was properly rejected by the District Court and Court of Appeals. Furthermore, the Tenth Circuit Court of Appeals' decision in *Olcott III* does not conflict with this Court's decisions or implicate the constitutional issues raised by the Petitioners. Accordingly, it is respectfully submitted that the Petition for a Writ of *Certiorari* should be denied.

Respectfully submitted,

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No. 03-391

Supreme Court, U.S.
FILED
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OFFICE OF THE CLERK

In The
Supreme Court of the United States

MICHAEL GALESI, DELAWARE FLOOD COMPANY,
a limited partnership under the laws of Oklahoma;
DELAWARE FLOOD COMPANY 1976 DH;
DELAWARE FLOOD COMPANY 1977 EH;
DELAWARE FLOOD COMPANY 1978 FH;
DELAWARE FLOOD COMPANY 1979 Ltd.,

Petitioners,

v.

BERNARD OLCOTT,

Respondent.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Tenth Circuit

REPLY TO BRIEF IN OPPOSITION

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OTHER AUTHORITIES

Rule 16, Fed.R.Civ.P. 1

Fifth Amendment 1

I. The District Court Dismissed Respondent's Causes of Action

The Pre-Trial Order was prepared by counsel for Respondent, signed by counsel for Respondent and Petitioners, and signed by the District Court. The Pre-Trial Order said the order of February 4, 1998 dismissed Respondent's causes of action. Respondent's counsel complained to the District Court that the February 4, 1998 order would come back to haunt him if the conditional default judgment were not upheld on appeal. Most significantly, the understanding of all of the lawyers and of the District Court that the Pre-Trial Order's holding that all of Respondent's causes of action had been dismissed is amply illustrated by yet another provision of the Pre-Trial Order: *the Pre-Trial Order lists, under Respondent's "contentions", App. 140, ¶ 12, that Respondent did not agree to the dismissal of his causes of action, because the conditional default judgment may not be sustainable on appeal.*

The dismissal of Respondent's causes of action reflected in the Pre-Trial Order was never amended. The trial was conducted in accordance with the terms of the Pre-Trial Order.

Neither Rule 16, Fed.R.Civ.P., nor the Fifth Amendment, permits the Pre-Trial Order to be ignored on the grounds (as asserted by Respondent and the Tenth Circuit) the action of the District Court was an "unfortunate misstatement." No case supports such specious reasoning, nor could it – Pre-Trial orders are binding, and the case is tried on the basis of that order. There was no amendment to the Pre-Trial Order. Moreover, the district court's dismissal was anything other than inadvertent. Counsel for Respondent twice objected to the District Court's actions, noting that action might well cause trouble for him if the conditional default judgment were not sustainable on appeal.

Yogi Berra was correct in observing the game is not over until it's over, but it is equally correct that when it's

over, it's over. The District Court's Pre-Trial Order finding Respondent's causes of action had been dismissed ended the District Court's subject matter jurisdiction on anything other than collateral sanctions. A $3.6 million default judgment sanction is anything other than a collateral sanction. *Respondent, of course, has no one to blame for his predicament other than himself. He had every opportunity to cross-appeal the District Court's dismissal, but did not do so, bizarrely telling the Tenth Circuit in his answer brief there would have been no "pragmatic benefit" for an appeal.*

Respondent's Brief in Opposition, at 18, notes the portion of the Tenth Circuit's opinion (Petitioner's Appendix at 10) stating the District Court "merged" the claims into the default order, "in effect placing all substantive matters on hold pending resolution of the default order." There is absolutely nothing in the record supporting this absurd statement. The trial conducted by the District Court was "it" as far as this case was concerned. There were to be no other proceedings, no matter what. Moreover, the February 4, 1998 order does not speak of the "viability" of any of Respondent's claims – indeed, the only thing remaining to be done is to try the issues encompassed by the conditional default judgment, as set forth in Petitioners' Opening Brief at 16-17.

The District Court said at trial that if the accounting were provided, the judgment would still stand if credits could not be shown at the trial the District Court ordered. *See* Petitioners' Opening Brief at 8. Thus, by the District Court's own words, there was no further proceeding contemplated under any circumstances. The District Court's order of conditional default judgment, App. 49-50, sets forth one definitive proceeding, regardless of whether the accounting was provided:

> 4. Plaintiff is entitled to a judgment against the Defendants, jointly and severally, for his investment of $1.9 million dollars [sic] less any portion of those funds which Defendants can establish

> were utilized for legitimate purposes under the terms and provisions of the Limited Partnership Agreements. There will be a trial in which the burden will be upon the Defendants to establish to the satisfaction of the fact finder that any portion of Plaintiff's contribution was utilized for legitimate purposes under the terms of the agreements among the parties.
>
> 5. Defendants still must comply with the accounting Orders of this Court and correct the deficiencies as found by the Court's expert. The supplemental accounting will be completed and filed on or before May 31, 1990.

The District Court made some statements about Respondent's causes of action "merging" with the conditional default judgment, but there is no reflection of this view in any of the District Court's orders, including its post-trial order.

Even assuming the District Court had intended a further proceeding as the Tenth Circuit asserts contrary to the record, neither the Tenth Circuit, the District Court, nor Respondent has offered any case law or other analysis to support the extraordinary concept that claims can somehow be "merged" into a sanction/conditional default judgment, and at the same time have a life thereafter if the sanction/conditional default judgment issues are resolved and no default judgment is entered. **The only legally recognized concept of "merger" is that causes of action merge into a judgment, and only the judgment is operative from the date of the judgment forward. Here, there was no default judgment entered. Instead, there was a conditional order requiring a hearing to determine (a) the amount of credits Petitioners would be allowed and (b) if the required accounting were produced. Thus, by definition, there could be no "merger," because there was no judgment until one was entered after the hearing held in 2000.**

As to the District Court's May 5, 1997 order retaining jurisdiction over the pendant state law claims, that order indeed served as a jurisdictional basis for certain subsequent proceedings. But invocation of that order as a basis of jurisdiction has no control whatsoever over any subsequent order of dismissal. And it was the Pre-Trial Order of 8-9-00 that fixed in concrete the dismissal of Respondent's causes of action, duly noting the objection of Respondent's counsel (who prepared and signed the Pre-Trial Order) that such dismissal would cause trouble down the line if the conditional default judgment were overturned on appeal.

Dismissal is jurisdictional. There is no longer an Article III case or controversy when dismissal occurs. Yes, the court still has jurisdiction for collateral sanctions, but that is all. Respondent does not even discuss the requirements of *United States Catholic Conference v. Abortion Rights Mobilization, Inc.,* 108 S.Ct. 2268 (1988), which these facts fit within. The District Court conducted the trial as a mechanism to coerce the production of the required accounting. As noted by the Tenth Circuit in *Olcott II,* "[t]he purpose of the default judgment was to coerce the defendants into completing the accounting for trial. . . ." App. 114. As such, the 2000 trial was a civil contempt proceeding pursuant to the 2-8-90 order. Because there was no jurisdiction for the conduct of the civil contempt proceeding, the proceeding itself is void, just as the subpoena was in *Catholic Conference*.

II. Respondent's Brief in Opposition Studiously Avoids the Central Facts:

1. Respondent invested $1.9 million in four oil and gas limited partnerships, at year end.

2. In order for those year-end investments to qualify as 100% income tax deduction in the year of payment, Respondent had to part with all control of the monies paid.

3. In order to part with control of the monies paid, Respondent agreed that all of the year-end investment would be paid to a drilling contractor in a pre-paid contract. The drilling contractor took the risk the work would cost more than the payment.

4. In furtherance of Respondent's parting with control of the money he invested, the drilling contractor was permitted to commingle the year-end funds he received with his other operating funds.

5. At the time he signed each of the year-end partnership documents, Respondent had in front of him the contracts with the drilling contractor permitting usage of his money as it was used.

6. It is undisputed in this case Respondent had drilled each and every one of the wells he contracted to have drilled. In addition, it is undisputed Respondent received approximately $825,000 in cash and $700,000 in net federal income tax benefits. Of course, because the investment was in the drilling of oil and gas wells, there was no guarantee of any return whatsoever, if the wells were drilled.

Respondent's Brief in Opposition endeavors to obfuscate the relevant issues by making the argument that since it was not possible to trace each and every dollar invested by Respondent, somehow Respondent suffered harm. In order to get the $700,000 in income tax benefits, Respondent had to part with control of his money and make it available in the commingled unrestricted operating funds of the drilling contractor. The testimony on this point is uncontradicted in the record. Moreover, Respondent's *own expert* testified if all of the wells were drilled (as it is undisputed they were), and $1.9 million was the appropriate price for drilling the wells (it is undisputed $1.9 million was the market price), then Petitioners should have been credited the entire $1.9 million against the $1.9 million conditional default judgment!

III. Petitioners Were Sanctioned Twice for the Same Conduct

Petitioners were sanctioned $402,537.98, constituting complete payment of all expenses of Respondent (attorney fees and accounting fees) and of the District Court's expert, for Petitioners' failure to provide the required accounting. The District Court also ordered, one more time, that the accounting be produced and evidence be introduced to show what credits were allowable. When the District Court again found the accounting insufficient, he imposed a $3.6 million conditional default judgment. Thus, the District Court said, in effect, every time you do not turn in the required accounting, I am going to sanction you. And he did.

In imposing the $3.6 million sanction, the District Court ignored the undisputed fact Respondent got the benefit of his bargain (for which Respondent's own expert – previously the Court's expert – testified Petitioners should have been credited with the entire $1.9 million of Respondent's investment), and in addition to the allowed credits, Respondent got $700,000 in net income tax deductions.

IV. Respondent Ignores the Constitutional Issues Presented

Respondent's Brief in Opposition ignores the serious Constitutional issues presented in this Petition for Certiorari.

First. There is no reference to *United States Catholic Conference v. Abortion Rights Mobilization, Inc.*, 108 S.Ct. 2268 (1988). By his silence, Respondent concedes the $3.6 million sanction is non-collateral. Further, by his silence, Respondent concedes if the District Court did dismiss the claims of Respondent, *Catholic Conference* has been violated, and the sanction must be voided in the entirety.

Second. Both the Respondent's Brief in Opposition and the Tenth Circuit opinion are totally silent on the Due

Process implications of the imposition of a $3.6 million sanction where Respondent has already received $402,527 as a sanction, has received the benefit of his bargain, and also has received $700,000 in net income tax deductions and $825,000 in cash. Such a sanction is in gross violation of *United States v. United Mine Workers,* 330 U.S. 258, 304, 67 S.Ct. 677, 701 (1947), where the Court held if a civil contempt award is intended as a fine it must be based on evidence of the complainant's actual loss. Here, Respondent had no actual loss whatsoever.

Third. There is no reference to the Due Process issue presented by the imposition of $2.5 million for 21 years of pre-judgment interest awarded as part of the $3.6 million non-collateral sanction, when Respondent received the benefit of his bargain plus $800,000 in cash and $700,000 in net income tax benefits.

Fourth. Respondent's Brief in Opposition is silent as to the serious Constitutional issue presented by the Tenth Circuit's failure to review how much of Respondent's money was utilized in accordance with the terms of the agreements. The District Court ordered that the hearing be conducted to determine how much of Respondent's money was utilized in accordance with the terms of the agreements: Petitioners were to receive credit for "any portion of Plaintiff's contribution . . . utilized for legitimate [business] purposes under the terms of the agreements among the parties." Thus, the action of the District Court should have been reviewed by the Tenth Circuit. For the Tenth Circuit to refuse to review what the District Court did, on the basis to do so requires an interpretation of the agreements among the parties, is incomprehensible.

Fifth. There is no reference to the Due Process issue presented by the Tenth Circuit's creation of an appeal for Respondent on the issue of dismissal of his causes of action by the District Court, followed by Respondent's failure to appeal that dismissal.

Sixth. There is no reference to the Due Process issue presented by the assessment of a $3.6 million sanction in

light of the previous $402,537 sanction, Respondent having received the benefit of his bargain, and Respondent having received $800,000 in cash and $700,000 in net income tax benefits.

V. The Necessity for Resolving the Conflict Among the Circuits

In *Olcott II,* the Tenth Circuit had in front of it a cross-appeal of Respondent, asking the court to enter the 2-8-90 conditional default judgment order of the District Court, which order was not referred to in the appeal then before the Tenth Circuit, on the $402,537 sanction. The Tenth Circuit held it could not do so, because the District Court had dismissed all of the causes of action and this mooted the possibility of a trial. Thus, in *Olcott II,* the Tenth Circuit held the District Court had jurisdiction to proceed with the $402,537 collateral sanction following the dismissal of the causes of action, but did not have jurisdiction to proceed with a trial which would result in entry of the default judgment. The Tenth Circuit, facing its precedent in *Olcott III,* chose sleight of hand in two respects to get around its own precedent by [(i) creating an appeal Respondent did not make by saying the District Court misspoke when he signed the Pre-Trial Order prepared by Respondent and signed by all counsel and the District Court, and (ii) finding the District Court "misspoke" when he dismissed the causes of action].

Olcott III's finding there was jurisdiction to impose this non-collateral sanction conflicts with *In re Orthopedic "Bone Screw" Products Liability Litigation,* 132 F.3d 152 (3d Cir. 1997). The Second and Ninth Circuits have spoken on this subject, oddly and without persuasive support, and say non-collateral sanctions may be enforced in the absence of subject-matter jurisdiction. *See* Petitioners' Opening Brief at 27.

The decisions of the four circuits which have spoken on this important jurisdictional subject have not, except for the Third Circuit's opinion, been models of judicial interpretation or persuasion. This Court is asked to set the parameters for the exercise of Article III power when there is no subject matter jurisdiction, and non-collateral sanctions are at issue. A case in which one of the largest sanctions in the history of the United States is at issue, and in which Respondent got the full benefit of his bargain, $800,000 in cash and $700,000 in net income tax benefits, to say nothing of prior receipt of a sanction of $402,537 for the same conduct, would seem an ideal vehicle for this Court's examination of the requirements of Article III.

VI. Respondent's Brief in Opposition Egregiously Violates the Court's Rules and Should Be Stricken or Disregarded

The Court's rules require that any material cited from the record be contained in an appendix. Respondent's Brief in Opposition is replete with selective and misleading references to material not in the record presented to this Court. These references are found on pp. 4-8, 10-16, 20, 22, 23, 25 and 26. Moreover, Respondent's counsel placed a footnote, footnote 4, stating references to Respondent's Appendix would be to "RA," but there are no such references. Moreover, footnote 4 says references to Respondent's Appendix are designated by "RA", but in fact there are no references in the brief to "RA", except for the two incorrect references on p. 4 referring to "RA" when the correct reference is to "PA," Petitioners' Appendix.

The severity of the violation of the Court's rules should cause Respondent's Brief in Opposition to be stricken. Alternatively, all references in violation of this Court's rules should be disregarded.

VII. Conclusion

The Writ of Certiorari should be granted.

Respectfully submitted,

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